LAW AND CONTEMPORARY PROBLEMS

GOVERNMENTAL MARKETING BARRIERS

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CONTENTS

GOVERNMENTAL MARKETING BARRIERS

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FOREWORD

The extensive hearings before the Temporary National Economic Committee, the Committee's monographs and reports, together with the Department of Justice's ambitious program of antitrust enforcement, highlight the great amount of attention being currently paid—and properly so—to existing impediments to a free competitive market that are the result of private machination. Save with respect to the interstate trade barrier,[1] little attention has been directed to marketing barriers that are the consequence of governmental, rather than private, action. It is the purpose of the present symposium issue to present an inclusive picture of the extent and character of internal American barrier walls as they have been erected through legislation and administration, to probe something of the economic implications of this relatively unnoticed development, and to suggest the important bearing of the publicly created barrier on the immediate national defense effort and on the ultimate imponderables of political and democratic solidarity.

Writing last year on *The Bottlenecks of Business*[2] the present aggressive head of the Antitrust Division tended to minimize the dangers inherent in "public seizure of power over the market." To him then ". . . the acquisition of power over the market by public legislative processes is not a serious danger in a democracy checked and balanced as ours is."[3] This was ". . . because what has been granted by the democratic process can be safeguarded and can be taken away by the same democratic process."[4] "It is the private seizure of industrial power that . . . can wreck a democracy. That power is subject to no election every four years."[5] Even within his own official family, however, there was dissent from this view of things;[6] and, "increasingly disturbed by the amount of state and local legislation" of restrictive character, Mr. Arnold, in his recent appearance before the Temporary National Economic Committee,[7] testified to the ". . . close parallel between private restraints in proceedings under the antitrust laws and the public or quasi-public restraints which have become known as trade barriers"[8] in recommending Congressional action to strengthen Antitrust's hand in so far as that is possible.[9]

[1] Part 29 of the *T. N. E. C. Hearings* is devoted to "Interstate Trade Barriers."

[2] ARNOLD, THE BOTTLENECKS OF BUSINESS (1940). [3] *Id.* at 107. [4] *Id.* at 110.

[5] *Ibid.* But compare his discussion *id.* at 42-45, wherein he indicates the greater concern over public barriers that is evident in his more recent testimony, cited *infra* note 7, before the T. N. E. C.

[6] See Edwards, *Trade Barriers Created by Business* (1940) 16 IND. L. J. 169.

[7] See *Final Report and Recommendations of the T.N.E.C.*, SEN. DOC. No. 35, 77th Cong., 1st Sess. (1941) 261 *et seq.* [8] *Id.* at 269. [9] *Id.* at 270.

The closeness of the parallel between the two types of restraint is strikingly revealed in the recent antitrust indictment brought against the West Coast Lumber Manufacurers Association because of alleged abuses in the grade-marking of lumber. Paragraph twenty-seven cites that the defendants, in furtherance of their conspiracy, ". . . have drafted, sponsored and urged the enactment by towns and cities . . . of building codes and ordinances, which provide for and result in the exclusive use in building construction in said towns and cities of lumber bearing" defendants' grade-mark. As often, legislation or administration constitutes but the barriers effected by groups which, routed in the competition of the market place, have been able to make up in political influence what they lacked in economic power. There is thus little to distinguish the public from the private barrier to attainment of the free-market ideal; in the words of an able commentator, "The distinguishing feature of governmental trade barriers is public sanction, not economic effect."[10]

Nevertheless, especially where, as here, the term barrier is comprehensively used to embrace all manner of devices impinging adversely on maintenance of free market access, governmental intervention does not necessarily import bad economic judgment. Public action may represent a justifiable effort to defeat or counterbalance a private market force which, unchecked, will eventually destroy the very institutional foundations of the free market. Care must therefore be had to distinguish between such defensive public measures and those which thinly cloak the prostitution of governmental processes for the benefit of private groups which seek to enjoy for their monopolistic ambitions the blessings of public entrenchment. Nor is differentiation between these two classes of intervention sufficient; gradations in economic desirability or undesirability are inevitable within each type. Each public as well as each private assertion of power over the market must be judged against a composite measure of values that mirrors the marketing ideal.

Against this background there are presented in this issue fifteen analyses which together probe, it is believed, at least the more important ramifications of the pervading problem of governmental marketing barriers. In structural scheme the symposium opens with two discussions, one general, the other specific, of interstate trade barriers; follows with an analysis of the myriad types of non-geographical barriers today raised to the entry of persons and goods into the market; pursues successively an investigation into the more special restrictions on products and those on persons; reunites the two streams of development in papers on effectuation of marketing barriers by municipalities and by administrative bodies; then considers the over-all meaning of the general judicial tolerance of public barrier activity regardless of its type and economic effect; and closes with two discussions which serve to emphasize the significance of governmental marketing barriers both to our efforts at defense against physical aggression from without and to the maintenance of a political and industrial democracy at home that will withstand the dry rot which in other places has so greatly facilitated foreign doctrinal penetration from within.

FRANK R. STRONG

[10] Edwards, *supra* note 6.

INTERSTATE TRADE BARRIERS IN THE UNITED STATES

PAUL T. TRUITT*

An interstate trade barrier has been defined as "a statute, regulation or practice which operates or tends to operate to the *disadvantage* of persons, products, or services coming from sister states to the *advantage* of local residents, products or enterprises."[1] Examples of trade barriers are found widely distributed in substantial numbers among laws, ordinances, rules, regulations and administrative orders regulating production, distribution, and general commercial practice. These restrictive influences affect adversely the economical and practical operation of the marketing system. At present there is a lack of economic understanding of these laws; also, their broad vital implications are not sufficiently realized. This is doubtless due to the fact that the phenomenal growth of trade barriers is of comparatively recent origin.

Trade barriers have been divided into four types or classes.[2] These are (1) laws which on their face manifest a discriminatory purpose directed at out-of-state competition;[3] (2) laws which on their face are non-discriminatory, but which are discriminatory in practice;[4] (3) laws which on their face apply to residents and nonresidents alike, but which in operation burden out-of-state enterprise. The cumulative effect of such laws constitutes a trade barrier;[5] (4) laws which in effect

* B.S. in Business and Public Administration, 1924, University of Missouri. Since Nov. 1939, Chairman of the Interdepartmental Committee on Interstate Trade Barriers. Staff member, Division of Regional Economy, Bureau of Foreign and Domestic Commerce. Formerly economic analyst in the Procurement Division, U. S. Treasury. Extensive previous experience in private industry as operating executive, analyst, and buyer.

[1] Definition used for the trade barrier in 12 *Hearings before the Temporary National Economic Committee*, 76th Cong., 2d Sess. (1940) No. 10, at 265, hereinafter cited as *T. N. E. C. Hearings*.

[2] Testimony, A. H. Martin, Jr., Director, W.P.A. Marketing Laws Survey, *id.* Nos. 10 and 11.

[3] *E.g.*, N. C. Laws 1937, c. 127, §121(e), exacting an annual privilege tax of $250 from: "Every person, firm or corporation, not being a regular retail merchant in the State of North Carolina, who shall display samples, goods, wares, or merchandise in any hotel room, or in any house rented or occupied temporarily, for the purpose of securing orders for the retail sale of such goods, wares, or merchandise so displayed. . . ." This statute was recently declared invalid by the unanimous decision of the U. S. Supreme Court in Best and Co. v. Maxwell, 311 U. S. 454 (1940).

[4] *E.g.*, Idaho Laws 1937, c. 226: "Fruit sold in state must show place of origin." A wide degree of discrimination between local and out-of-state fruit is possible under this type of statute. CAL. AGRIC. CODE §§781-831 ". . . establishes minimum standards of grades and containers for specified fruits and vegetables. Unlawful to ship or sell non-conforming goods: inspection fee to be paid by owner."

[5] Thus an itinerant trucker in Washington is subjected to a license of $300 per vehicle by each county through which the vehicle may pass. WASH. REV. STAT. (Remington, 1932) §§8353-8355. NEB. COMP. STATS. (Supp. 1939) §§66-427, 66-805 require the Department of Agriculture and In-

create trade barriers by virtue of unfair and discriminatory administrative practices. Virtually any law may be administered in favor of local enterprise if administrative agencies, which often enjoy discretionary authority, elect to take a partisan slant in the framing of rules and orders; consequently, no example is cited.[6]

Each of the classes of trade barrier laws enumerated above has been enacted and is administered under one of three sovereign state powers.[7] First is the power of taxation. This category may be subdivided into the following three parts: (1) taxes which are levied to exclude out-of-state products or services in favor of the products or services of a home enterprise; (2) taxes levied to eliminate or curb a competitive type of merchandising; (3) taxes which, because of their multiplicity when encountered in interstate commerce, have a cumulative barrier effect. Second, is the police power exercisable for the protection of the public health, safety, morals, and welfare, including the powers to inspect, quarantine, and embargo animals, plants, and other products moving in interstate commerce. Third, is the power inherent in a state through its proprietary interest in its own natural resources.

It should be emphasized at this point that there is no intent herein to criticize the states for properly exercising these powers. The dangers lie in the abuse of these powers by pressure groups to achieve interstate market restrictions. These abuses do not make state sovereignty more secure; rather they tend to impair it. Increased demands for relief, by those discriminated against, are made upon the Federal Government with the appearance of each new trade barrier situation. The cumulative effect of these demands may yet become the motivating influence producing a greater degree of federal control. A prompt and adequate solution of this question by the states themselves would nullify the possibility.

HISTORICAL BACKGROUND[8]

During the pre-Revolutionary days the colonists struggled with many economic problems, not the least of which was that of the regulation of trade among them-

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spection to designate highways and establish registration offices for inspection and registration of motor vehicle fuels transported in large quantities. Any truck with tank capacity of more than 20 gallons must stop at a registration office and pay tax on fuel in excess of 20 gallons.

[6] No studies of administrative orders, rules and regulations issued under various statutes have been made. Sampling by the W.P.A. Marketing Laws Survey indicates the existence of an enormous amount of this type of control. For example, a bundle containing only single copies of orders affecting marketing from the state of Illinois alone, issued by ten agencies in that state, weighed 282 pounds. Bane, *Administrative Marketing Barriers, infra* this issue, gives typical illustrations of barriers effectuated by administrative action.

[7] See note 2, *supra.*

[8] See BOGART, ECONOMIC HISTORY OF THE UNITED STATES (ed. 1938) Pt. 1; VAN METRE, ECONOMIC HISTORY OF THE UNITED STATES (ed. 1921) Pt. 2; FAULKNER, ECONOMIC HISTORY OF THE UNITED STATES (ed. 1928) cc. 1, 2, 3; CLARK, HISTORY OF MANUFACTURES IN THE UNITED STATES (1929); BIDWELL AND FALCONER, HISTORY OF AGRICULTURE IN NORTHERN UNITED STATES, 1620-1860 (1925); BRUCE, ECONOMIC HISTORY OF VIRGINIA IN THE 17TH CENTURY (1935); DAY, HISTORY OF COMMERCE IN THE UNITED STATES (1925); JOHNSON *et al.*, HISTORY OF DOMESTIC AND FOREIGN COMMERCE OF THE UNITED STATES (1915); JANESON, THE AMERICAN REVOLUTION CONSIDERED AS A SOCIAL MOVEMENT (1926); DEWEY, FINANCIAL HISTORY OF THE UNITED STATES (12th ed. 1934); BEARD, AN ECONOMIC INTERPRETATION OF THE CONSTITUTION OF THE UNITED STATES (1913); FISKE, THE CRITICAL PERIOD IN AMERICAN HISTORY (1901); STORY, COMMENTARIES ON THE CONSTITUTION (1833) §§259-261; The Federalist, No. XLII (1788) 5; Madison, *Introduction,* in ELLIOTT, DEBATES (1827) 109-22; Hacker,

selves.[9] Domestic commercial problems became intensified with the growth of the colonies and through the Revolutionary period. In 1783, George Washington, in a circular letter to the states, urged "the prevalence of that pacific and friendly disposition among the people of the Union, which will influence them to forget their local prejudices and policies; to make those mutual concessions which are requisite to the general prosperity; and, in some instances, to sacrifice their individual advantages to the interest of the community."[10]

The ties that bound the states together immediately following the Revolutionary War were tenuous and inadequate. It was all too evident within the next six years that Washington's advice was not to be taken. It appeared that the newly formed Union would soon become a series of disunited and unorganized states, each easy prey for larger world powers. No really strong sentiment had matured favoring the Union; there was, instead, much opinion in favor of local self-government. Much of this feeling stemmed from commercial rivalry between the states, as was ably set forth by Madison,[11] and caused concern to the thoughtful men of that day.[12] It was clear to the delegates to the Annapolis Commercial Convention[13] in 1786 and to those of the Philadelphia meeting the following year that ways and means must be found to reduce the friction between the states, and to control more satisfactorily domestic commerce.[14]

The record shows that every plan put forward at the Philadelphia Convention included a wide grant of power to the Federal Government to regulate interstate commerce. No serious objection was raised to the commerce clause as it finally took shape.[15] It provides that Congress shall have power "To regulate commerce

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The First American Revolution (Sept. 1935) 27 COL. UNIV. QUAR. 257. Also, these texts contain extensive bibliographies, appended chapter by chapter, which will be of value to those desiring a more detailed historical background.

[9] Mr. Justice Catron in the Passenger Cases, 7 How. 283, 445 (1849), said: "Before the Constitution existed the states taxed the commerce and intercourse of each other. This was the leading cause of abandoning the confederation and forming the Constitution—more than all other causes it led to the result."

[10] 26 FITZPATRICK, THE WRITINGS OF GEORGE WASHINGTON FROM ORIGINAL MANUSCRIPTS SOURCES, 1745-1799 (1938) 487.

[11] Madison, *Preface to the Debates in the Convention of 1787*, in 3 FARRAND, RECORDS OF THE FEDERAL CONVENTION OF 1787 (1927) 547.

[12] See 1 BANCROFT, HISTORY OF THE CONSTITUTION (1883) 334, for an expression of this concern.

[13] This Convention was called to "take into consideration the trade of the United States; to examine the relative situation and trade of the said states; to consider how far a uniform system in their commercial relations (might) be necessary to their common interest and their permanent harmony; and to report to the several states such an act relative to (that) great object, as when unanimously ratified by them (would) enable the United States in Congress assembled effectually to provide for same." ELLIOTT, DEBATES (1827) 115-116.

[14] As might have been expected, the states were not unanimous in their efforts to improve current conditions. Rhode Island, often called "Rogues" Island, an active participant in commercial fights, failed to participate in the Constitutional Convention of 1787, a fact which significantly indicates the importance the Convention attached to trade barrier activities. Madison said "Rhode Island was the only exception to a compliance with the recommendation from Annapolis, well known to have been swayed by an obdurate adherence to an advantage which her position gave her of taxing her neighbors through their consumption of imported supplies, an advantage which it was foreseen would be taken from her by a revisal of the Articles of Confederation." 3 FARRAND, *op. cit. supra* note 11, at 546.

[15] SCHUYLER, THE CONSTITUTION OF THE UNITED STATES (1923) 115.

with foreign nations, and among the several states and with the Indian Tribes."[16] This provision is the constitutional guarantee of free trade among the states.[17]

The first serious recession from the principle of domestic free trade grew out of the fraud and adulteration in food products which became rampant after the War Between the States. Business ethics, following the war, reached a low ebb and it is perhaps not surprising, considering the abuses of that time, and in the absence of federal regulation, that the states sought to control certain commercial malpractices by enacting stringent tax laws. The first oleomargarine tax laws are in point.

In addition to regulation to combat fraudulent practices, the growing irregularity of legitimate marketing processes in itself warranted governmental regulation. Weights, measures, quality standards from Maine to California required policing. In addition quarantines were needed to eradicate or control the spread of animal and plant diseases.

However, coupled with the need for and appearance of numerous trade regulations there emerged two dangers. One was that the sheer multiplicity and complexity of these regulations might unintentionally hamper trade. This has happened. The other was that a trend might develop to use such measures to erect barriers against competitors, while at the same time providing a benefit to local enterprises. This too has happened, and these happenings have engendered hostility and animosity between the states on different issues. Retaliatory barrier legislation has been enacted, confusion has resulted, and consumers have been penalized to such an extent that today trade barriers are a threat to the welfare of the nation.

PRESENT EXTENT OF INTERSTATE TRADE BARRIERS

In the last two decades the growth of trade barrier laws and regulations has "passed beyond the stage of mere curiosa into the socially, economically, and politically dangerous realm of local autarky."[18] The depression starting late in 1929 dealt severe blows to state financial programs in two ways. There occurred a drastic reduction in taxable values and tax receipts, accompanied by a markedly increased demand for the expenditure of public funds. Slack business, widespread unemployment, and declining tax revenues faced the state legislatures in the early thirties. Thus the stage was set for the appearance of the majority of the present laws, rules and regulations characterized as trade barriers.[19]

[16] CONST., Art. I, §8, clause 3. Two other provisions having a bearing on trade regulation were included in the Constitution. They are Art. I, §9, cl. 6, prohibiting Congress from preferring the ports of one state to those of another; Art. I, §10, cl. 2, prohibiting a state, "without the consent of Congress, from laying any imposts or duties on imports or exports, except that which may be absolutely necessary for executing its inspection laws. . . ." However, following the implications to the contrary of Chief Justice Marshall in Brown v. Maryland, 12 Wheat. 419 (U. S. 1827), the Supreme Court has since ruled in Woodruff v. Parham, 8 Wall. 123 (U. S. 1869); Pittsburgh Coal Co. v. Louisiana, 156 U. S. 590 (1895); Patapsco Guano Co. v. Board of Agriculture, 171 U. S. 345 (1898), that these clauses refer only to foreign commerce.

[17] See, for instance, the unequivocal declaration of Mr. Justice Roberts in Milk Control Board v. Eisenberg Farm Products, 306 U. S. 346, 351 (1939), and that of Mr. Justice Hughes in the Minnesota Rate Cases, 230 U. S. 352, 398 (1913).

[18] The Economist, London, Sept. 23, 1940.

[19] As put by Buell, *Death by Tariff* (Aug. 1938) 18 FORTUNE 32: "the principle fundamental to prosperity is now being violated; protectionism turning inward has been invoked by state against state, industry against industry."

The amazing growth of trade barriers during the early thirties was noted occasionally by students[20] and writers.[21] It remained, however, for Governor Allred of Texas to focus the attention of the Council of State Governments[22] on this menace early in 1937. The Council adopted the trade barrier problem as a part of its national program in 1938. Their first step was to call a national trade barrier conference in Chicago in April, 1939.[23] To provide the basic material for this conference the Council requested the Marketing Laws Survey of the Works Progress Administration to extract from its current study on *Entry Into Business* a tabulation of state laws creating or tending to create trade barriers among the states. The Survey prepared charts of their findings, which were later published,[24] showing extracts from state laws in the following categories: motor vehicles, 301 examples; dairy products, 209; oleomargarine, 245; livestock and general foods, 138; nursery stock, 145; liquor, 125; use taxes, 109; general preference, 113; commercial fishing, 35; and insurance, 69 examples. This tabulation totals 1,489 state laws.

At the joint request of the Council and the Interdepartmental Committee,[25] the Marketing Laws Survey later prepared a digest of trade barrier laws for the nine states whose legislatures met in 1940. This digest covered the additional categories of chain stores and transient merchants, including a chart on reciprocity. It has been estimated that the final classification will show over 3,000 trade barrier laws now on the statute books of the 48 states.

It is encouraging to note that since the 1939 National Conference few new trade barrier laws have been passed. However, few have been repealed. The problem of solving permanently the trade barrier question divides into these two parts, namely, prevention of the passage of new barrier laws and revision of the great bulk of present laws to remove barrier features.

Trade barrier laws are widely spread over the country according to the economic interests of a state or group of states. Consider margarine taxes and license fees, for example. On margarine made from domestic fats and oils only, ten states impose a manufacturer's annual license fee of from $5.00 to $1,000, fourteen states impose a wholesaler's annual license fee of from $3.00 to $500, thirteen states impose an annual retailer's license fee ranging from $1.00 to $400, nine states impose a tax on all margarine sold of from 5 to 15 cents per pound. Wyoming, Nebraska and Minnesota, cattle-producing states, tax at from 10 to 15 cents per pound all margarine sold within their borders made from other than animal fats. Further, when margarine is made from imported fats and oils, additional states levy restrictive taxes and fees.[26] State preference laws are also widespread. All states except Alabama

[20] Notable is MELDER, STATE AND LOCAL BARRIERS TO INTERSTATE COMMERCE (1937).

[21] A bibliography is available upon request from the U. S. Bureau of Foreign and Domestic Commerce.

[22] For history, organization, program, and achievements of the Council of State Governments, see THE HANDBOOK OF THE STATES (1940).

[23] For a complete record see PROC. NAT. CONF. ON INTERSTATE TRADE BARRIERS (Council of State Gov'ts, 1939).

[24] *Comparative Charts of State Statutes Illustrating Barriers to Trade Between the States* (W.P.A. Marketing Laws Survey, 1939).

[25] See note 46, *infra*.

[26] Testimony of Charles H. Janssen and John R. Moloney, 12 *T. N. E. C. Hearings*, *supra* note 1, No. 11, at 305-321.

have one or more forms of preference laws requiring the use of local stone, coal, printing, equipment, clothing, farm products, and labor for state purposes.

The variety in motor truck regulation is striking.[27] There are ten single unit length requirements in the 48 states for a 6-wheel tractor and trailer, only 19 states having a common standard. Weight requirements for this type equipment vary from "not specified" to 44,000 pounds, there being 22 different requirements. Ten states, in this particular, have a common standard, but no two are adjacent. Pay load limits vary from the Texas maximum of 7,000 pounds, if destination is other than a rail head, or 14,000 pounds if destination is rail head, to 78,000 pounds in New York. Gross load requirements vary from 18,000 in Kentucky to 120,000 pounds in Rhode Island.

Barriers are equally evident in the field of agricultural inspection and quarantine. All states exercise this power in some fashion.[28] Twenty-six states require out-of-state nursery stock dealers to register and to buy a license. In one state the quarantine authority may bar out-of-state products when the domestic supply is sufficient for home needs.[29] Thirty states provide for inspection upon entry of products into the importing state. In this field the non-uniformity of state requirements relating to duplicate invoices, special state and special commodity tags, permits, dealers' and agents' fees, registration fees and bonds constitutes a cumulative trade barrier of great magnitude.[30] The penalty for violation of these multitudinous restrictions may be revocation of license, confiscation of property, or excessive terminal inspections, with a consequent loss of merchandise.

Space limitations do not permit an exhaustive survey of the present extent of the trade barrier movement in each classification in which barriers have been noted; however, the examples quoted may be considered fairly typical of those found in other classes.

ECONOMIC IMPLICATIONS

It is unfortunate that no complete and thorough-going analyses have been made of the economic effects of trade barriers. The newness of the issue and the magnitude of expected difficulties thus far constitute practical deterrents to those interested in developing such data. Students have been forced to make deductions based on individual cases and to generalize along the lines of orthodox economic theory. However, from practical observations, we know that trade barrier restrictions force the movement of goods and services through artificial channels. As a consequence costs are increased and eventually a rise in price follows, or at best future price reductions are made less likely. These effects, sometimes arising in narrow areas, are often hard to discover as they become diffused throughout the domestic economy.

[27] See chart on this subject cited in note 24, *supra*.

[28] Testimony of R. P. White and Carl C. Lumry, 12 *T. N. E. C. Hearings, supra* note 1, No. 12, at 357-365.

[29] *I.e.,* Georgia's 1935 law authorizing the Commissioner of Agriculture to embargo out-of-state fruit and vegetables when local supplies are ample. Ga. Laws 1935, p. 371.

[30] McClain and White, *Plant Quarantines as Trade Barriers* (Amer. Ass'n Nurserymen, 1940).

They are nonetheless serious. In certain cases they may be traced with comparative ease. For example, the effect of the Kentucky 18,000 pound load law on operating costs is clear from the testimony before the Temporary National Economic Committee at the trade barrier hearings.[31] Shippers of leather between Chicago, Illinois, and Middlesboro, Kentucky, were forced to reload shipments from one to two vehicles at Louisville. Aside from the not inconsiderable delay and added terminal costs, actual freight rate costs were increased approximately 50 percent over a single vehicle operation. This increase must be paid by the shipper and added to the cost of the merchandise.

The dairy industry affords many examples of the economic effects of trade barriers. Farmers producing at low cost in Indiana cannot sell their cream in New York City and Washington, D. C., markets on account of numerous inspection requirements. This situation benefits neither the midwestern producer nor the eastern consumer. Prices paid to the Indiana farmer are low. Prices paid by the eastern consumer are higher than they would be in a competitive market.[32]

In general, it can be said that trade barriers tend to lower the standard of living. This is illustrated by the excise taxes and license fees imposed on oleomargarine. The magnitude of these costs to the producers and sellers of this commodity is sufficient to shut it entirely out of some states and to reduce sales in others.[33] Restrictions thus contrived are doubly depressing on living standards since they bear more heavily on the lower income groups. Figures compiled by the U. S. Bureau of Home Economics[34] show that the lower the income of a family the less butter they buy. A family with a weekly expenditure amounting to from $4.00 to $4.99 per adult or adult equivalent buys about 40 pounds of butter per year per adult or adult equivalent and practically no margarine. A family similarly classified with a weekly expenditure of from $1.33 to $2.00 buys only 12 pounds of butter per year and over 8 pounds of other table fats including margarine. It is evident, therefore, that any tax on margarine falls largely on the low income group. Further, the total consumption of margarine is reduced by these restrictions since the product would sell for considerably less in certain markets were it not so heavily taxed. Any degree of underconsumption in margarine serves to reduce the domestic market for oils, imported and domestic, animal and vegetable, with a consequent detriment to American farmers.

[31] Testimony of John V. Lawrence, 12 *T. N. E. C. Hearings, supra* note 1, No. 14, at 422. Further data may be found in Investigation and Suspension Docket No. M-404, 18 I. C. C. (Motor Carrier) 265 (1939).

[32] Testimony of Messrs. Ruehe, Treadway, Money, Witham, Freeman and Creighton, 12 *T. N. E. C. Hearings, supra* note 1, No. 12, at 341-357. Also testimony of Mrs. Beatrice A. Schalet, *id.* No. 13, at 381-384.

[33] Testimony of Charles A. Janssen and John R. Moloney, *id.* No. 11, at 305-321; also Truitt, *Interstate Trade Barriers and the Cotton Industry* (address before the Cotton Research Congress, June 1940).

[34] Steibling and Phipard, *Diets of Families of Employed Wage Eearners and Clerical Workers in Cities,* U. S. Dep't Agric., Circular No. 507 (Jan. 1939); *How W.P.A. Wages Are Spent* (April 1940) 50 MONTHLY LABOR REV. 929.

Convincing evidence of the uneconomic character of certain trade barrier laws may be seen in the arguments of their proponents. Many such cases are on record where they clearly state that a law should be passed to provide protection from domestic competition.[35] It is interesting to note that where the public has been

[35] *E.g.*

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"Whereas, oleomargine is sold in direct competition to butter; and

"Whereas, the prosperity of the farmer depends upon the price he gets for his product; and

"Whereas, the prosperity of the merchants and meat markets depend on the prosperity of the farmers; therefore be it

"Resolved, that we, the undersigned farmers and dairymen respectfully petition the merchants and meat markets of Polk County, Wisconsin, to discontinue the sale of butter substitutes.

"Be it further resolved, that we urge all our citizens to use their best influence to eliminate butter substitutes from Polk County, inasmuch as they are only food substitutes, and are injurious to public health, and our Polk County citizens' prosperity depends upon the dairy industry." Wisconsin Cooperative Creamery Ass'n, May 31, 1921. See J. S. Abbott Bull. No. 12, March 1928, Munsey Bldg., Washington, D. C.

"Resolved, that we favor legislation against the manufacture and sale of any substitutes for dairy products, believing that the manufacture and sale of such products to be detrimental to the health of the public as well as harmful to the dairy industry.

"Resolved, that we endorse the continued good work of the National Dairy Union in protecting the dairy interests relative to the sale of substitutes for butter." Nat. Creamery Buttermakers Ass'n annual convention, 1923. Printed in Butter, Cheese and Egg Journal, Nov. 14, 1924.

"We are opposed to any changes in the present federal oleomargarine law until it can be shown that a better law can be enacted to prevent fraud and deception in the sale of this product." Hoard's Dairyman, Oct. 5, 1938.

"In 1935 the National Cooperative Milk Producers Federation petitioned the Congress to enact three types of legislation:

"1. A new federal tax of five cents a pound on all oleomargarine.

"2. The equivalent of an import, excise or processing tax of at least five cents per pound on all imported fats and oils used in the United States.

"3. A federal law to prohibit the use of interstate commerce to nullify state oleomargarine taxes." PABST, BUTTER AND OLEOMARGARINE (1937) 85. Also Oleomargarine, *Hearing before Subcommittee on Agriculture on H. R. 5586 and H. R. 5587*, 74th Cong., 1st Sess. (1935) 181.

The interest of the dairy industry in protecting the public by prohibiting or by restricting the sale of products they believe to be detrimental to the public as well as harmful to the dairy industry, in the case of oleomargarine does not seem to be well founded. A comparison of the violations of the Pure Food and Drugs Act of 1906 between butter court cases and oleomargarine court cases fails to support the contentions of the dairy interests. The following table, showing the court record of the two industries, is compiled from *Notices of Judgment* (Bull. issued by the U. S. Food and Drug Adm'n). The name of the defender and the nature of the violation, there given, are omitted here.

Fiscal Years	*Butter Court Cases*			*Margarine Court Cases*		
Ending June 30	Prosecutions	Seizures	Total	Prosecutions	Seizures	Total
1925	85	188	273	0	1	1
1926	59	143	202	1	3	4
1927	24	79	103	0	3	3
1928	54	104	158	0	1	1
1929	22	98	120	0	1	1
Calendar Years						
1930			148			0
1931			172			2
1932			154			0
1933			187			1
1934			464			0
1935			263			0
1936			140			1
Total			2,384			14

permitted a referendum, it has rejected tax laws which would have created serious trade barriers.[36]

Trade wars between states, while having marked uneconomic aspects, often are accompanied by very undesirable results of a social or political[37] nature. Sectional bitterness is created which is hard to eradicate. In the opinion of many students this particular factor on the continent of Europe played an important part in precipitating the present European economic and democratic breakdown.[38] We are not free from such controversies in the United States; the controversy between the dairy and cotton states over the repeal of the margarine taxes is a case in point.[39] Such bickerings do not contribute to greater national unity. Former Governor Starks' phrase, "The Balkanization of the United States," is not idle verbiage.

During the years from 1925 to 1936 the production ratio between creamery butter and margarine varied between 5 to 1 and 7 to 1; hence the butter industry with a volume of from 5 to 7 times that of the margarine industry was in court at least 15 times to the margarine industry's once.

II

"The session of the Legislature of Kentucky, which closed on March 14, wisely declined to enact legislation proposed to increase the size and weight of trucks permitted on the highways of that State. . . . The Kentucky Railroad Association, and the railroad brotherhoods, along with the individual efforts of railroad officers and employees, helped to arouse many newspapers, county judges, various civic and commercial organizations, the operators of ordinary automobiles and small trucks, and the public in general, to the evils which an increase in the loads permitted on the highways would bring about. . . . Admittedly, railroad employees had a legitimate interest in opposing truckers who were diverting business from the railroads and thus depriving railroad men of employment. . . . This message, therefore, is to point out the successful result of cooperation between railroad employees and management, where they can agree upon a common purpose. . . ." President's Message No. 61 (April 1940) 16 L. & N. EMPLOYEES' MAG. No. 4.

For further typical activity see Investigation of Railroads, Holding Companies and Affiliated Companies, *Hearings before a Subcommittee of the Senate Committee on Interstate Commerce*, 75th Cong., 2d Sess. (1937) Pt. 23, at 10161-10215.

III

"Behind the move to repeal the city's . . . license ordinance which operates . . . as a tariff against itinerant . . . merchants is the smoldering threat of a trade war. . . .

"Local dealers . . . fear nearby cities . . . may pass reprisal ordinances . . . repeal would throw the market wide open . . . depriving local dealers who pay local taxes, of trade. . . ." Indianapolis Times, Oct. 26, 1940, quoted in Sikes and Parrish, *Municipal Trade Barriers* (1940) 16 IND. L. J. 220. Extracts of actual clippings from newspapers, trade journals and periodicals, showing similar trade-barrier motives behind nuisance ordinance legislation, are to be found with the testimony of J. M. George, Nat. Ass'n of Direct Selling Cos., Winona, Minn., 12 *T. N. E. C. Hearings, supra* note 1, No. 13, at 384.

[36] Oregon has four times rejected margarine tax laws upon referendum, as follows: Nov. 1920, by 119,126 to 67,101; Nov. 1924, by 157,324 to 91,597; Nov. 1932, by 200,496 to 131,273; and Nov. 1936, by 114,524 to 66,880. California has done likewise twice, in Nov. 1926 and Nov. 1936, the latter time by 1,359,096 to 345,470.

[37] In one state two candidates for office of sheriff ran for reelection on a platform of non-enforcement of the state's motor vehicle laws. SEN. DOC. No. 152, 73d Cong., 2d Sess. (1934) 195 n.

[38] See Kunstenaar, *Internal Marketing Barriers in Europe: Pre-Hitler Austria as an Outstanding Example, infra* this issue; testimony, Dr. F. Eugene Melder, Clark University, 12 *T. N. E. C. Hearings, supra* note 1, No. 11, at 273-281; Furth, Address before the American Marketing Association, Dec. 27, 1939.

[39] See Wis. Joint Res. No. 84, Wis. Laws 1939, p. 1031, adopted in an effort to placate southern states whose cottonseed oil, made into margarine, is virtually shut out of Wisconsin. "Wisconsin's oleomargarine tax law has decreased the consumption of the product in that State from 10,000,000 pounds per year to about 5,000 pounds." J. Comm., Oct. 15, 1940, quoting Wisconsin's Progressive candidate for governor.

TRENDS IN SOLUTIONS

The very nature of the trade barrier question makes mandatory a consideration of the existing powers of various branches of the Federal Government to effect its solution. For a considerable period the Supreme Court has enunciated applicable principles by which state legislatures might be guided. While it is recognized that generalities do not solve specific cases, broad guiding criteria are useful. By the exercise of the "police" powers the states cannot impose burdens on interstate commerce which are "direct."[40] In instances where Congress has not occupied the field, however, regulations of the states may, in fact, burden interstate commerce even though such burden may not be designated as "direct" by the courts. Yet in cases where discrimination against interstate[41] or foreign[42] commerce is obvious on the face of the state law, it will not be upheld by the Supreme Court. It is clear that the court will look into the facts of each case to determine the extent to which the statutory provision at bar operates as a burden on interstate commerce. This procedure is best illustrated in *McCarroll v. Dixie Greyhound Lines*[43] in which the Court used arithmetical calculations to show the mischief of the Arkansas statute.

The dissenters in the *McCarroll* case[44] took occasion in their opinion to emphasize that the regulation of interstate commerce was primarily the duty of Congress. When Congress chooses to act, because its power over interstate commerce is plenary, all conflicting state laws must give way. Nevertheless, as has been pointed out by many students, Congress has not assumed comprehensive jurisdiction in this area. It may be argued that, owing to the great climatic and geographic variations in the United States, complicated further by variations in urbanization and industrialization, the maximum degree of centralized control by Congress possible under the Constitution would be so laden with administrative difficulties as to be impractical. Such arguments, however, should not blind public officials to the detrimental effect of trade barriers on the national domestic economy. Trade barriers should weigh upon Congress in direct ratio to their burden upon interstate commerce.

Following the trade barrier hearings before the Temporary National Economic Committee,[45] the Interdepartmental Committee[46] decided that the next logical step in any remedial program would be an examination of the present federal statutes to "determine how far such legislation can be used either directly to set aside or indirectly to influence the modification of state laws and local ordinances which are barriers to trade." This task was assigned to an eleven member Legal Subcommittee

[40] This well accepted constitutional doctrine is forcefully set forth by Mr. Justice Cardozo in Baldwin v. Seelig, 294 U. S. 511, 522 (1935).

[41] Best and Co. v. Maxwell, *supra* note 3.

[42] Hale v. Bimco Trading Co., Inc., 306 U. S. 375 (1939).

[43] 309 U. S. 176 (1940).

[44] *Id.* at 188-189.

[45] Reported in 12 *T. N. E. C. Hearings, supra* note 1, Nos. 10-15. The Committee examined 29 witnesses of divergent background, covering various phases of the interstate trade barrier problem.

[46] The Interdepartmental Committee on Interstate Trade Barriers is an informal voluntary group, formed upon the suggestion of former Secretary of Commerce Hopkins to act as a clearing house and coordinating group in the trade barrier field. Representatives from the following agencies compose this Committee: U. S. Dep'ts of Commerce, Labor, Justice, State, Treas., Agric., the U. S. Tariff Comm., I. C. C., Fed. Works Agency, and the Consumer Counsel Div. of the Dep't of Agric.

set up for this purpose. In presenting the following list of administrative actions which, in the opinion of the Subcommittee, could possibly be taken to combat interstate trade barriers, it must be emphasized that the Subcommittee was not concerned with matters of policy or expediency. The Subcommittee attempted to discover power. It did not attempt to pass judgment on the wisdom of using such power.

Through the cooperative action of interested federal agencies, the Interdepartmental Committee on Interstate Trade Barriers and the Council of State Governments, considerable persuasive pressure could be exerted in forestalling the enactment of trade barrier legislation and in combating trade barrier legislation which has been enacted.

State and local laws may, on their faces, constitute a restraint on interstate trade or they may sanction administrative action which can be used to this end. Also, state or municipal officers may act *ultra vires* to suppress or restrain interstate commerce. The filing of briefs *amicus curiae* by the Department of Justice, injunction suits under the theory of the *Debs* case,[47] and anti-trust prosecutions are techniques which may be effective in combating these restraints of trade practices.

Concerted policy on the part of federal agencies, of bringing cases before the United States Supreme Court which would clarify and possibly broaden the existing judicial concept of interstate commerce, might materially aid litigants who are burdened by trade-restricting state laws.

The Federal Trade Commission is empowered to undertake an investigation of interstate trade barrier problems.

A uniform seed law is now being prepared by the Department of Agriculture, while the standard milk ordinance of the Public Health Service has been adopted by many communities. The Interdepartmental Committee on Interstate Trade Barriers might effectively assist in advancing this type of administrative action.

The Surgeon General may call special conferences of state health boards and of state health officers. Moreover, he is authorized to detail personnel to cooperate in activities such as are being carried out by the Interdepartmental Committee.

Under the Federal Food, Drug and Cosmetic Act, the existence of trade barriers with respect to any commodity might well be taken under consideration in prescribing regulations. In this connection, reference is made to state labeling laws, to state laws specifying sizes of containers and to state laws governing the quality of milk and cream. Moreover, it is believed that administrative action publicizing the situations in which barriers to interstate shipments have developed in this field might be possible under this federal legislation.

Under the Agricultural Marketing Agreement Act of 1937, it is believed that the Secretary of Agriculture has sufficient discretion in setting up administrative conditions precedent to needed federal cooperative action to require that state reg-

[47] *In re* Debs, 158 U. S. 564 (1895).

ulations relative to state marketing agreements with respect to milk and its products be promulgated with a view toward eliminating trade barriers.

Under Section 3 of the Animal Industry Act, the Secretary of Agriculture is authorized to cooperate in execution and enforcement of provisions of the act working toward the suppression of dangerous, contagious, infectious, and communicable animal diseases. It would appear that, pursuant to the authority contained in the statute, he could, through the exercise of authorized discretion in formulating or approving plans and methods for combating contagious animal diseases, exert economic measures which might be successful in eliminating the trade barrier aspects of animal quarantines.[48]

As a general proposition it would seem that whenever a specific trade barrier exists in the states, the operation of which materially interferes with or hampers a project financed in whole or in part by federal appropriations, those administering the expenditure and the granting of such funds may attach conditions that will operate to remove the objectionable trade barrier.

With particular reference to trade barriers, the states have been cooperating among themselves quite effectively during the past two years.[49] These efforts have resulted in a practical halt in the trend toward more barrier laws. In the main, the job now confronting the states is one of legislative revision to eliminate barrier provisions from the large body of present state law which has been thus classified.[50] Much of this law should be revised on a more uniform basis. This is especially true of the motor regulatory laws, from which it is necessary to remove requirements that impose a cumulative burden on interstate commerce.

For the past 50 years the states have kept the Conference on Uniform Laws in existence and functioning. Up to the present time the Conference has approved 70 uniform acts which have been adopted by the various states, ranging from 35 in South Dakota to 3 in Texas. Broadly, the efforts of the Conference are directed toward removing friction between the states, preserving the independence of the states, and at the same time making our dual system of state and federal government function more smoothly. The Conference recently joined forces with the Council of State Governments in order more effectively to focus their efforts on their fifty-year goal of bringing about greater uniformity in state law. Although the results of this group have been worth while,[51] it has not yet been active on the trade barrier question.

The use of interstate compacts has long been available to the states in solving mutual trade problems. The effectiveness of this intergovernmental device as a

[48] *A Summarized Report of the Legal Subcommittee of the Interdepartmental Committee on Interstate Trade Barriers*, giving the subcommittee's conclusions in greater detail, is available without cost from the U. S. Dep't of Commerce.

[49] For detailed evidence consult the source books referred to in notes 22 and 23, *supra*.

[50] The classification of the Marketing Laws Survey is cited note 24, *supra*.

[51] Saeta, *Unified Legislation Cited as Goal of Conference on Uniform State Laws* (Dec. 1940) 15 CAL. STATE B. J. 359; and *Uniform State Law Group and the Council of State Governments Join Forces* (Aug. 1940) 13 STATE GOV. 153, 3rd cover.

method of eliminating trade barriers is yet to be proved. Pacts have recently been completed in the fields of crime control, water resources, oil conservation, tobacco regulations, and park, bridge, and transportation authorities. A large portion of the total compacts now in force deals with boundary and jurisdictional adjustments, harbor problems, water resources, and engineering projects. Only a very few deal with economic or trade questions.[52]

From the variety of suggestions, proposals and counter-proposals for the solution of the trade barrier problem, a line of likely successful attack seems to emerge—and that is a cooperative effort between the Federal Government and the states. It seems probable that the Court will make short work of such flagrant and outstanding barrier cases as may come before it, but to everyday use of the judicial procedure there are the practical limitations of time and expense involved in long litigation. Congress may or may not, subject to the exigencies of the day, undertake a more complete and thorough-going regulation of interstate commerce in areas now infested with trade barrier practices. And action by the states alone has inevitable limitations.

A joint approach, however, would seem to obviate many of the disadvantages inherent in an approach relying wholly on the courts, the Congress, the Federal Government, or the states, acting separately. It is apparent that the complicated task of commercial regulation, because of its relationship to individual livelihoods, demands sensitive treatment. Legislation affecting such interests should be enacted only upon the facts established by thorough economic and legal research and after consideration of all interests involved. The collective guidance and experience of representatives of both federal and state governments seem required for this purpose.

At the trade barrier hearings before the Temporary National Economic Committee the Executive Director of the Council of State Governments proposed that Congress create a joint federal-state committee.[53] The Temporary National Economic Committee, in its Final Report,[54] has recommended such a committee; moreover, former Secretary of Agriculture Wallace[55] earlier publicly endorsed the prosopal. Representatives of state governments meeting in Washington in the Fifth General Assembly of the Council of State Governments reaffirmed their stand against trade barriers. Resolutions were adopted which, if zealously followed by the states, will go far towards permanently curing this trouble.[56] At the present time attention is

[52] *Recent Development in Interstate Compacts*, in THE BOOK OF THE STATES (1939-1940) adapted from Dodd, *Interstate Compacts* (1939) 73 U. S. L. REV. 75, 86-88, 124-127; Routt, *Interstate Compacts and Administrative Cooperation* (Jan. 1940) 207 ANNALS 93; Dutton, *Compacts and Trade Barrier Controversies* (1940) 16 IND. L. J. 204.

[53] See testimony of Frank Bane, 12 *T. N. E. C. Hearings*, *supra* note 1, No. 10, at 271.

[54] *Final Report and Recommendations of the Temporary National Economic Committee*, SEN. DOC. No. 35, 77th Cong., 1st Sess. (1941) 34.

[55] See letter from Vice-President Wallace, when Secretary of Agriculture, to Senator O'Mahoney, 12 *T. N. E. C. Hearings*, *supra* note 1, No. 15, at 472.

[56] Adopted Jan. 23, 1941, the Resolutions read as follows: "Whereas; the National Conference on Interstate Trade Barriers, held in Chicago in April, 1939, considered at length the barriers which obstruct the free flow of commerce throughout the nation in agriculture, industry, labor and other fields, and whereas as a result of this Conference and of the work of those participating in it existing trade barriers were repealed, and new ones aborted, blocked and vetoed, and

being concentrated on observing the course of the trade barrier movement in the 43 state legislatures which meet in 1941. If these states fail to achieve needed legislative revision, it may be taken as an indication that some type of joint federal-state undertaking is a requirement for the solution of this problem.

"Whereas; free trade among the several states is imperative in the interest of national defense and the promotion of unity,

"Now therefore be it resolved that this General Assembly request the Council of State Governments, through its Commissions on Interstate Cooperation, to continue this important work by:

"1. Discouraging the introduction in the legislatures of trade barrier bills or of any retaliatory legislation by states which feel themselves aggrieved by the legislation of their neighbors.

"2. Encouraging repeal of trade barrier legislation which may have already been adopted by the several states.

"3. Encouraging the enactment of uniform laws, and the adoption of reciprocal agreements or interstate compacts which have for their aim the reduction of trade barriers between the states.

"4. Initiating regional hearings throughout the United States, such hearings to be officially called by the Commissions on Interstate Cooperation in conjunction with the Council of State Governments, in order to follow through the recommendations made by this General Assembly and by the National Conference on Interstate Trade Barriers.

"5. Urging Governors to veto legislation which would clearly result in the erection of additional trade barriers.

"6. Establishing a Joint Committee on Federal-State relations for the purpose of considering trade barrier problems having to do with federal-state relations.

"Be it further resolved that in order to provide facilities for the conciliation of specific differences between states resulting from trade barriers, this General Assembly recommends that the State which considers itself adversely affected by the legislation of another state petition the Council of State Governments to use its good offices to arrange a conference with the State which has enacted the offending legislation before taking any other action."

INTERSTATE BARRIER EFFECTS OF THE USE TAX

Reynold E. Carlson*

During the past decade many types of legislative barriers have been erected to obstruct the marketing processes. Some were directed to specific commodities such as oleomargarine, dairy products, and liquor, while others were intended to protect local trade channels and methods of distribution against the incursions of outside agencies such as chain stores, mail-order houses and itinerant merchants. Among the latter measures is the use tax. It is singled out for study in this article, first because of the many erroneous impressions that exist concerning it, and second because of the legal-economic problems which it raises.

Origins of the Use Tax

The use tax is a levy upon the privilege of using, storing or otherwise consuming tangible personal property within a given state. It appears to be an attempt by state legislatures, when operating under significant pressures, to complement the sales tax and so to eliminate an obstacle which, it is alleged, seriously interferes with the enforcement of the primary sales tax law. The proponents of use taxes may be divided into two distinct groups, one concerned with the protection of revenue and the other with the protection of business.

Protection of Revenue

The widespread adoption of sales tax laws was largely the result of shrinking revenues accompanied by expanding demands for expenditures on the part of the states for welfare, aid to municipalities, and relief from the pressure on the real property tax base. It then became possible, by making retail purchases outside the state, to avoid payment of the sales tax. Consequently many state tax administrators, whose first duty is the collection of state revenues and who are inevitably jealous of encroachments upon their revenue sources, align themselves with the proponents of use taxes on the ground that such a law will discourage purchasing outside the state as a means of avoiding the sales tax.

Just how extensive the alleged loss in sales tax revenues may be is difficult if not impossible to ascertain. Certainly a large volume of business went to out-of-state firms before states began to adopt sales taxes, and to say that all such business was "lost" to a state immediately upon adoption of its sales tax would be absurd. The

* B.S., 1936, M.A., 1937, Northwestern University; Ph.D., 1941, Harvard University. Instructor in Political Economy, The Johns Hopkins University. Formerly Director of Research on Interstate Trade Barriers, Harvard University. Publications in taxation, economic history, and interstate trade barriers.

only revenues which can be considered "lost" are the receipts which might have been obtained upon those purchases intentionally made elsewhere to avoid payment of sales tax. However, if the many utterances on this revenue aspect are taken as a guide, apparently tax officers usually estimate their lost revenue on the total purchases made outside the state.

Even if attention be focused upon those purchases made out of state for the primary purpose of avoiding sales tax, it is virtually impossible to ascertain their volume. The most palpable cases of wholesale tax avoidance would seem to arise whenever cities are situated on opposite sides of a state line and in close proximity to each other. Then a real incentive might develop for purchasing in that market which has no sales tax, the larger and more expensive commodities such as furniture, clothing, autos and machinery. Some attempts have been made to estimate quantitatively the volume of business which shifts as a result of a sales tax in one of two contiguous cities.[1] Isolated surveys, although by no means conclusive, suggest that the amount of diversion due to the sales tax is extremely small and the corresponding loss of revenue negligible. Information furnished the author by a leading mail-order concern confirms this fact; it reported "no noticeable increase in mail-order sales when a state passed a sales tax law."

Protection of Business

The second large group supporting the use tax as a supplement to the sales tax consists of retail merchants and those who must compete with firms located in other states. Most of the contentions advanced by use tax adherents fall into this category and much of the appeal for popular support has been based on protection to local business, with all of its variations. Space does not permit tracing the steps by which the argument, beginning on revenue grounds, is gradually shifted until finally it declares the necessity of protecting intrastate enterprise from unfair competition—a far cry from pure revenue considerations.[2] To some observers this emphasis represents a recrudescence of the old protectionist bias, which is now being extended to specific states and their subdivisions.[3] Behind almost every trade-barrier law, however, there is a mixture of motives: revenue, protection of industry, welfare consideration and others. Consequently, to dispose of all so-called trade barriers as a logical extension of the old protectionist dogma would greatly oversimplify the problem and ignore some of its far-reaching ramifications.

The protection argument has been advanced to make the sales tax more acceptable to the retailers who must undergo considerable expense and inconvenience in col-

[1] N. D. Tax Survey Comm., *Report No. 7* (1936).

[2] The final statement of this position is to be found in such passages as the following taken from the Mississippi Compensating Tax Law, Miss. Laws 1938, c. 114, §1: "The primary purpose of this Act is hereby declared to be to protect the merchants, dealers, and manufacturers of Mississippi who operate under the privilege tax laws, against the unfair competition of importations into Mississippi without payment of the Retail Sales Tax of goods, wares, or merchandise usually carried for sale in this state." Any reference to protection of revenues is conspicuously absent; the whole emphasis is now placed upon protection to local business from "unfair" competition.

[3] See Walker, *State and Local Protectionism* (July 1940) 18 TAXES 407.

lecting and accounting for the tax. Thus retailers are induced to accept this burden if they can be convinced that the use tax eliminates unfair out-of-state competition. At the same time the argument has been used effectively to create some semblance of popular support for use taxes, without which the necessary legislation could not be enacted. It is alleged that the general public will "also commend the tax as an equitable adjunct to the sales tax."[4] Or as one enthusiast put it:[5]

> . . . the use tax is likely to become Michigan's first popular and universally approved tax because it was adopted primarily for the benefit and protection of Michigan merchants.

The major tenet of the protection-of-business group is the need for restoring the same competitive conditions that existed before sales taxes were adopted. If all tangible personal property be subject to a uniform tax regardless of where purchased, then "local merchants will be placed upon an equal competitive basis with those outside the state."[6] To this end the use tax is urged as an appropriate measure, for it "places the seller in the state on an equal footing with his out-of-state competitor, or competitor within the state who makes an interstate sale."[7] Yet judging by some utterances, the merchant group is less interested in neutralizing the local effect of a sales tax, than it is in adopting measures which would tend to equalize the competitive advantages from whatever source derived. Employed in this fashion, a tax originally intended to neutralize a specific disadvantage to local trade may well become a positive barrier to the flow of commodities into the state.

TRADE BARRIER ASPECTS OF THE USE TAX

Attempts to define the expression "trade barrier" are frequently couched in terms of advantages to local residents and industries.[8] However, an advantage to one group may be offset by a corresponding disadvantage to other groups in the same state, with the result that there is no "net" local gain. Thus a margarine law is advantageous to the dairy interests, but is at the same time a real burden to low income groups which are denied use of a tablespread and must turn to unsatisfactory substitutes. Whether the claimed advantage outweighs the alleged disadvantage in such a situation is a question of policy for each state legislature to decide. It remains for the economist to demonstrate that disadvantages can follow from the adoption of trade barrier laws, and that such laws are not, by any means, an unmixed blessing for the residents of the state. Moreover, a working economic definition ought not to be bound by the legal arguments on trade barriers. The *sine qua non* of a trade barrier is economic, not legal, and the approval of so-called barrier statutes by the Supreme Court does not close the record or write *finis* to any analysis of the problem. This point is important because some state administrators are asserting that a statute, which the Court declares to be within the plenary power of the state, is not a trade barrier. Such laws must also appear before the

[4] Jenner, *The Use Tax in Washington* (1939) 32 PROC. NAT. TAX ASS'N 262.
[5] Allen, *Discussion* (1937) 30 *id.* 50.
[6] *Id.* at 48.
[7] Rinisland, *Discussion*, *id.* at 45.
[8] See Truitt, *Interstate Trade Barriers in the United States*, *supra* this issue.

bar of economic analysis and be judged according to their effects on the structure of the national as well as the state economy.

Analysis of Judicial Criteria of Validity

It was not long before the first use-tax statutes were challenged in the courts, and a number of decisions have been handed down by the Supreme Court validating the tax itself as well as the methods used to collect it.[9] The development of the legal criteria which were to cut neatly between use taxes and unlawful burdens upon interstate commerce, evident in those decisions, has been traced in various publications and need not be considered.[10] It is the economic validity of those governing criteria which must be weighed in order to appraise the barrier effects of the use tax.

The rationale supporting constitutionality is well summarized in the following passage from Mr. Justice Cardozo's opinion in the progenitor case of *Henneford v. Silas Mason Co.*:[11]

> But a tax upon use, or what is equivalent for present purposes, a tax upon property after importation is over, is not a clog upon the process of importation at all, any more than a tax upon the income or profits of a business.

Inasmuch, then, as the property had come to rest the Court reasoned that taxation of its use could not be said to hamper commerce, whereas a tariff, either for protection or revenue, burdens the act of importation and so becomes unlawful for a state. Yet if it can be shown that in some cases the flow of specific commodities—the process of importation—is completely stopped or seriously disrupted, it would clearly be wrong to reason that the use tax is not a "clog." One of the major purposes of the tax was to protect business by discouraging the importation of commodities from other states. It was hoped that the interstate business would then return to local dealers whence it had been driven by the sales tax. To the extent of this motivation, then, the successful operation of a use tax depends upon increasing the volume of intrastate business by discouraging people from buying out-of-state goods. If there be no decrease in the flow, say, of consumer goods into the state, the tax has failed.

Nor is the situation improved economically by legalistic emphasis upon the fact that[12]

[9] Henneford v. Silas Mason Co., 300 U. S. 577 (1937); Felt & Tarrant Mfg. Co. v. Gallagher, 306 U. S. 62 (1939); Southern Pacific Co. v. Gallagher, 306 U. S. 167 (1939); Pacific Telephone & Telegraph Co. v. Gallagher, 306 U. S. 182 (1939), have concerned the constitutionality of the use tax. Monomotor Oil Co. v. Johnson, 292 U. S. 86 (1934); Felt & Tarrant Mfg. Co. v. Gallagher, *supra;* Nelson v. Sears, Roebuck Co., 61 Sup. Ct. 586 (1941); Nelson v. Montgomery Ward & Co., 61 Sup. Ct. 593 (1941), have considered the validity of efforts to require out-of-state concerns to aid in use tax collection. Court decisions on gasoline taxes are relevant in any discussion of general use taxes, as the *Monomotor* case itself attests, for they constitute a backlog of judicial analysis which has for the most part been carried over into the more recent decisions on general use taxes.

[10] Warren and Schlesinger, *Sales and Use Taxes: Interstate Commerce Pays Its Way* (1938) 38 COL. L. REV. 49; Lockhart, *The Sales Tax in Interstate Commerce* (1939) 52 HARV. L. REV. 617; WATERS, USE TAXES AND THEIR LEGAL AND ECONOMIC BACKGROUND (Kans. Bus. Studies, 1940).

[11] 300 U. S. 577, 586 (1937).

[12] *Ibid.*

. . . the goods when used in Washington after the transit is completed will share an equal burden with goods that have been purchased there.

Because the effect of a duty upon the subsequent use of a commodity is virtually the same as one levied upon its introduction, this notion of equal burden is palpably unsound from an economic viewpoint. In each instance the result is likely to be a reduced volume of interstate trade either because the tax is added to the price to discourage buyers or because it is absorbed by the seller, making less profitable the continuance of business with that state. "Burden" thus means one thing to the jurist and quite another to the economist. The legal conception of burden appears to be an abstraction deduced without probing backwards into the motives of the lawmakers or forward into the incidence and effects of the tax law.

A related economic paradox is the facility with which the Supreme Court interprets the taxable transactions of storage, use or consumption. Judicial treatment of the selective gasoline tax is illustrative. These cases reveal a concept of "use" much broader than that ordinarily associated with consumption, one that encompasses a whole series of events finally culminating in consumption. Under such a view the mere handling of gasoline could be construed as a use and so taxable. As one economist has put it, the microscopic isolation of separate uses by fine-spun differentiation is but sheer casuistry. Were a state to levy a tax upon each of the uses subject to its jurisdiction, the most elementary knowledge of tax incidence would recognize the extraordinary cumulative burden falling upon the consumption of gasoline in interstate commerce. In contrast with this legal metaphysics, the economist analyses use taxes in terms of consumption. This means a final use which exhausts the commodity either instantaneously, *e.g.*, the consumption of gasoline, or over a long period of time, *e.g.*, the use of a machine. Thus had the Court employed consumption instead of "use" as the criterion of the gasoline use tax, its decisions might well have turned the other way.

A similar sacrifice of economic logic to legal rhetoric is apparent in the recent Supreme Court decisions decreeing the enforced cooperation of the two leading mail-order houses as collection agents for the Iowa use tax.[13] The Sears Roebuck Co. had been authorized to do business in Iowa since 1928 and had, in the course of time, established a number of retail stores which produced annually over $5,000,000 in sales. On this retail business the usual sales tax was paid; on orders placed through these retail outlets and delivered from out of the state, use tax was collected. The issue was joined in the matter of use tax on mail-order sales when the orders went directly to the out-of-state office and shipment was made directly to the consumer. The volume of such business derived entirely from catalogs was also over $5,000,000 and roughly equaled the retail sales. Essentially the same were the facts in the companion case involving Montgomery Ward and Co.

Argued in terms of the Commerce Clause and the Fourteenth Amendment, the real point at issue in both cases was the use of the company as a collection agent.

[13] Nelson v. Sears, Roebuck Co., Nelson v. Montgomery Ward & Co., both *supra* note 9.

Earlier cases raising the question had involved local activity by a foreign corporation, whereas the mail-order business, it was contended, was wholly interstate. This view was rejected by the Court which declared the entire Iowa business of each concern to be a unit. In the words of the majority opinion in the *Sears Roebuck* case:[14]

> . . . whatever may be the inspiration for those mail orders, however they may be filled, Iowa may rightly assume that they are not unrelated to respondent's course of business in Iowa. They are nonetheless a part of that business though none of respondent's agents in Iowa actually solicited or placed them. Hence to include them in the global amount of benefits which respondent is receiving from Iowa business is to conform to business facts.

Thus it was held the state could require collection of the use tax as the price of all the benefits flowing from Iowa business.

The company argued, and quite correctly, that it was in competition with other mail-order houses which, since they had no local business connections, could not be forced to collect the use tax. To this the Court replied:[15]

> But those other concerns are not doing business in the state as foreign corporations. Hence unlike respondent, they are not receiving benefits from Iowa for which it has the power to exact a price.

Although the "impotence of state power" prevents a state from reaching any mail-order houses not doing local business in that state, the economic fact still remains that Sears Roebuck is in competition with such firms. This competition is, of course, limited to the sphere of mail-order sales; in the retail field Sears Roebuck receives benefits from the state for which it must pay a price. So long as it continues the local trade it must be presumed that that business is profitable. But, in considering the mail-order sphere alone, the company must meet competition quite apart from any benefits received or profits earned on the retail stores. All are engaged in interstate commerce. The association with retail stores is wholly incidental to the mail-order sales; nevertheless the Court allows it to be used as a lever to force conditions upon the company which place it at a competitive disadvantage in the mail-order line. To condition the operations of one company and not others is to substitute expediency for equity. The interstate business of one concern is burdened while others escape simply because a state enacts tax laws which cannot adequately be enforced either for administrative reasons or because the state lacks sufficient power to force collection at the source.

These decisions set for the present the high-water mark of the Supreme Court's efforts to compromise effectively between the right of the state to obtain revenue and the obligation of the state to leave interstate commerce unburdened and unregulated. The distinction between intrastate and interstate business is blurred, and indeed completely obliterated whenever both types of trade are carried on by the same company. As yet the state cannot enforce its will upon such companies

[14] Nelson v. Sears, Roebuck Co., *supra* note 9, at 589. [15] *Ibid.*

unless they are licensed to do local business or maintain offices and local agents to solicit orders. However, the majority opinions in the mail-order cases open the way for making the use tax in effect a tax upon sales. What started out as a tax upon the privilege of use has in fact metamorphosed into a tax upon the privilege of selling in interstate commerce.

Multiple Tax Burden

The extent to which the use tax may operate as a barrier to interstate trade is primarily an economic question of tax incidence, and the corollary effects and burdens which result therefrom. But before turning to this analysis, some brief mention may be made of the circumstances under which multiple taxation occurs. The question of discriminating or double taxation resulting from the use tax has been covered by several writers but the possibilities have not been fully explored. While several instances will be set out below, limitations of space require the most cursory treatment.

In the first place ten states include an offset provision in their laws, with the result that a commodity consumed in the state is not liable for a use tax if it has already paid an equivalent amount in sales tax to the state of origin. This ostensibly prevents a double taxation. The fact that seven states do not have this provision supports the earlier assertion that advocates of use taxes in these states were not interested in re-establishing the relative competitive position that existed before the sales taxes were adopted; it is clear that they were concerned there with protection to business even at the cost of burdening out-of-state competitors.

Secondly, double taxation may be avoided to some extent by allowing a monthly exemption quota for purchases made out of the state. Six states make such allowances in amounts varying from $50 per quarter year to $100 per month. While these exemptions represent a practical compromise with the difficulties of enforcement, the retail merchants in such states are receiving virtually none of the protection they anticipated from the tax.

Thirdly, the usual discussion of double taxation turns on the matter of two taxes levied upon a single commodity, a sales tax in the state of purchase and a use tax in the state of consumption. In this situation the use tax may become a "positive barrier." The extent of this type of barrier is probably limited to the occasional purchases made by individuals or companies in one state and transported by them into another state for consumption. Where the out-of-state purchases are handled as interstate transactions, only the use tax is paid so that no double taxation can be said to exist. To gain the tax immunity which has always been accorded interstate commerce, the commodity must actually be shipped from the seller to the buyer across state lines. While no quantitative evidence is available, it is a reasonable presumption that the bulk of the dollar volume of goods imported into a state is handled in this manner. For other transactions, which cannot qualify as interstate, double taxation is a reality unless the state provides that a sales tax paid elsewhere

may be offset against the use tax liability. The Supreme Court has not yet declared itself specifically on this type of double taxation, though the nature and breadth of its decisions on the use tax make unlikely any provision for relief.

Fourthly, failure to exempt products which cannot be procured in the buyer's state, or which are not produced there, is sometimes cited as a "positive barrier" on the ground that no protection is accorded home industry.[16] But whether a home industry is or is not protected is immaterial; the tax may still operate as a barrier. As the Supreme Court has indicated, the use tax is a valid exercise of state taxing power, not because it gives protection to local industry but in spite of it.

Use taxes assume significance as trade barriers because of the effect they may have upon the competitive advantages between two states or two regions of the country. The tax is levied upon any and all commodities (barring specific exemptions) that come into a state. The conditions which surround the production and sale of commodities vary widely. Some goods are sold with a small mark-up over cost in the expectation that the volume of sales will be sufficient to produce the desired profits. A use tax which cannot be shifted to the customer may wipe out the small margin and make such business unprofitable. Moreover, when goods are shipped great distances across the country and incur high freight charges, the use tax is levied on the price *including* freight. This clearly is a burden upon firms seeking to sell in a distant market in competition with other firms located close to that market. Whenever the trade barrier effects of the use tax tend to destroy or even equalize competitive advantages they prevent the maximization of the social income and contribute to an uneconomic distribution of resources within the framework of the economic system.

This leads to a final comment upon that form of double taxation which may arise as a result of the great diversity in the tax structures of the several states. Two states, *A* and *B*, may choose to finance a given expenditure in different ways; state *A* levies a sales and use tax of, say, two percent while state *B* raises an equal revenue by an increase in property tax rates. Thus a commodity manufactured in *B* will have a higher cost of production owing to the added tax upon plant and equipment. It may be assumed, for this hypothetical example, that the price of each commodity is increased by two percent when sold in their respective states. If the manufacturer in state *B* sells any goods in state *A* the price will be increased a second time, by the amount which must be paid as sales or use tax.[17] In brief, two taxes are being levied upon the commodity, a property tax (state *B*) and a sales or use tax (state *A*). In order to compete the producer in state *B* must absorb one of the taxes and so reduce his profit margin. If that margin happens to be two percent, he may discontinue selling in state *A*. Competitive disadvantages of this type are, of course, not peculiar to the use tax. They arise whenever two states have different laws which give the producers of one an advantage over the producers of the other.

[16] See Walker, *Discussion* (1939) 32 PROC. NAT. TAX ASS'N 235-236.

[17] On the other hand, a manufacturer in state *A* may sell in state *B* at a price two percent lower than can his competitor. He will pay neither sales nor property tax on the amount thus sold.

Incidence and Burden of the Use Tax

The incidence of the use tax is a matter of first importance in view of the many claims made in behalf of the tax by its proponents. Few if any of the tax administrators give evidence of having stopped to analyze the question of incidence. They usually dispose of the problem by declaring it is intended to be a consumer tax; so of course, it falls on the consumer! No recognition is given to the types of commodities being "consumed," although they may range everywhere from a railroad freight car to a pair of shoes purchased from a mail-order house. Both are subject to use tax, but it is not at all clear that the incidence of the tax is the same in each case. The only economist who has written a volume on use taxes confines his treatment to the legal and administrative problems and completely avoids any discussion of incidence.[18]

The incidence of the tax may vary with the administrative methods of collection. Consumer collection may be sub-divided into, first, collection by the ultimate consumer and, second, that by the processor who uses machinery in his business. For the ultimate consumer any payment of use tax rests entirely upon him; the impact and incidence of the tax are identical. For the processor, however, the situation is complicated by the possibility of shifting the tax to his customers in higher prices. A use tax will increase the cost of his equipment which, like any fixed cost, must be amortized over the entire output during the service life of the machine. At the same time his direct or variable costs will be increased by use taxation of fuel and raw materials employed in processing. With the unit cost of the product greater by these additions to fixed and variable costs, the processor is faced with the alternative of absorbing the increase, thus reducing his profit margin, or shifting it in higher prices.[19]

The second half of the incidence problem follows from collection of use taxes by the seller. The types of sellers involved may vary from a small retailer negotiating a local sale with out-of-state delivery, to a large mail-order concern handling everything from its offices in another state. Here, as in the case of the processor, the seller has the alternative of absorbing or shifting the tax. Limitations of space do not permit any extended analysis. Suffice it to say that the demand side of the problem seems to be a factor of some importance for a seller dealing directly with individuals on whom the tax will be overtly placed. The extent of the public's knowledge is another factor. Wherever buyers are ignorant of any levy of a use tax by their own state, they will resist its collection by an outside retailer. Furthermore, losses in good-will, to say nothing of losses in trade, may result from enforced collection in such circumstances.

Estimates prepared by mail-order companies as to their losses in collecting the

[18] WATERS, *loc. cit. supra* note 10.

[19] There are many technical considerations entering into this problem, such as: (1) the elasticity of demand for the product, (2) the existence of competitors in non-tax states selling in the same market, (3) whether there is excess capacity in the industry, (4) whether the processor is operating under optimum cost conditions, and so on. These interesting aspects cannot be explored in this article.

use tax provide a good study in tax incidence, although they must be considered in light of the fact that the problem of shifting the use tax is clearly more acute for the mail-order concern than it is for the local retailer who deals with the customer over the counter. If the customer fails to include the tax with his remittance to the mail-order concern, the order is filled anyway and a deficiency bill sent for the amount of the tax. Experience of the Sears Roebuck and Montgomery Ward companies in sales tax collections on mail orders indicates that only 65 to 75 percent of the orders remit the tax. Roughly half of the deficiency bills are collected. Collection at the source consequently imposes a considerable burden upon the mail-order firms. On the basis of $5,000,000 mail-order sales in Iowa, for 1937 the two percent use tax liability of Sears Roebuck would be $100,000. If notices were printed in their catalogs the company would expect about $68,000 in tax collection at an administrative cost (clerical and mailing expense for deficiency bills) of $13,000. On the other hand, if no notices were inserted, collections would only be $35,000 at a cost of about $18,000 in clerical expenses. Thus Sears Roebuck stands to lose: $21,000 in uncollected taxes plus $13,000 expense, or a total of $34,000 if a notice is inserted; without such a notice the loss would be $65,000 in uncollected taxes plus $18,000 expense, or a total of $83,000. To be sure, these are only estimates but after making any reasonable allowance for error the company is still left with a substantial tax burden. In the latter example it may cost the company $83,000 in order to pay $100,000 to the state of Iowa! This burden rests entirely upon the Sears Roebuck Company; no further shifting to the consumer is feasible.

From this brief analysis of the incidence of the use tax one conclusion seems inescapable. It is that an error has been committed by most tax administrators in ignoring the problem, or declaring categorically that use taxes fall on the consumer. There are evidently a number of highly probable conditions which may lead to different results. For instance, a processor faced by competition from non-tax producers and by excess capacity in the industry will absorb the use tax. A retail seller may absorb or shift the tax depending upon which of two forces is dominant: (1) competition from tax-free retailers and/or lack of knowledge on the part of buyers will encourage absorption; (2) small profit margins coupled with inability of the consumer to get tax-free commodities from other sources will probably result in a shifting of the tax.

An analysis of use tax receipts[20] reveals some interesting facts regarding the burden of the exaction. In the state of Oklahoma, for example, oil, public utilities (including transportation), and construction industries (including building materials) accounted for 80 percent of total revenue. The other 20 percent was scattered among all other types of business operating in the state, no one of which produced as much as 5 percent of the use tax revenue.[21] This situation reveals the hollowness

[20] Actual use tax collections for 1940, expressed as a percentage of sales tax revenue, varied from less than 1 percent in Mississippi to about 7 percent in Washington.

[21] Okla. Tax Comm., *Ann. Rep. of Consumers and Use Tax Statistics* (1940 and earlier years). A study of comparable data from Iowa and New Mexico yields similar results.

of the familiar argument that use taxation protects local industry, especially the retailers of food, wearing apparel and general merchandise. Manufacturers in practically every case buy their equipment outside the state because their special needs cannot be filled locally. Hence the use tax becomes a new and independent source of revenue to the state and bears no relation to the sales tax which it was, ostensibly, to supplement.

CONCLUSION

Several inferences may be drawn from the above examination. In the first place the problem of use tax incidence is primarily a question of a tax on the processor since such taxes make up the great bulk of use taxes collected. Subsidiary questions arise with reference to public utilities and government units where the incidence may conceivably fall more directly upon the final consumer, *e.g.*, the utility customer who pays a regulated price and the taxpayer who must provide for his local government's expenditures.

Secondly, the allegation of use tax administrators that the tax is a levy on consumers to supplement the sales tax is completely erroneous. The use tax is a new source of revenue whose full weight falls upon certain industries which have always purchased raw materials and equipment outside the state. Moreover, in most cases there is no local industry in the heavy goods range to be "protected."

Thirdly, the above points have significance for the questions of discrimination and burdens in interstate commerce. The use tax was upheld by the Supreme Court on the basis of a privilege, an attribute of property, which was taxable by the state. But suppose the only privileges which can be reached for taxation are those of a limited group, small in number but possessing substantial wealth in a form accessible to the tax collector? Is a statute which may be valid on its face, still valid if it is so administered as to exempt the vast majority of the very privileges it set out to tax? A tax may be levied upon a proper object within the plenary power of the state; it may be measured in an acceptable manner. Yet the subsequent operation of the tax cannot always be foreseen by the courts, and judged by the economic criterion of equity, a tax which is only administered over half the field is perhaps worse than no tax at all.

As noted elsewhere in this issue,[22] a program to check the spread of interstate trade barriers should work for the revision of present state laws to eliminate the barriers contained in them. Such action might be facilitated by demonstrating to the respective legislatures first, that the benefits expected from such a device as the use tax are illusory; second, that it fails to accomplish its stated objective, namely the protection of local business; and third, that it constitutes just one more tax upon business enterprises in that state. If such a demonstration could be made for the several types of trade barriers, and presented effectively by an interested group in each state, some real progress might be made in removing such statutes from the books.

[22] See Truitt, *Interstate Trade Barriers in the United States*, *supra* this issue.

CONTROL BY LICENSING OVER ENTRY INTO THE MARKET

Irwin W. Silverman* L. T. Bennett, Jr.† Irvin Lechliter††

Much has been said and written concerning the weaknesses of the distributive processes in America. Undoubtedly, economic forces are at play which clog these processes and thereby militate against the efficient functioning of our capitalistic society. That some of these forces are aided and abetted by ill-advised legislation presents, on its face, a sound premise. Legislation inspired by a sincere and conscientious effort to avoid chaos or collapse of our industrial structure may be just as deadly. Whatever be the objectives of these measures, there is today, under governmental paternalism, an ever-growing mass of restrictive legislation operating to close the avenues of entrepreneurship to untold numbers who might otherwise be engaged in productive activity.

To criticize or evaluate motives back of this legislation is not the purpose of this paper. That licensing legislation is restrictive no one will deny. That the state must exercise some degree of control over persons and products in the field of commercial activity is also generally conceded. But, whether such restrictive measures are of benefit to the public and are essential to a more orderly economic society is highly problematical. In the alleged interest of the consumer and defended by doctrines couched in such hackneyed phrases as police power, public health, and public welfare, a mushrooming of legislation has spread designed to effectuate governmental supervision and control through licensing over many types of trades, businesses and occupations. Among those now embraced are barbers, plumbers, dry cleaners, watchmakers, tailors, food dealers, and bakers. And, of late, the state legislatures have shown a distinct tendency toward expanding this concept of licensing to include the regulation of product as well as personal competition.

The National Industrial Recovery Act unquestionably provided a temporary stimulus for both industrial and commodity types of control through licensing legislation. Its invalidation by the Supreme Court of the United States[1] did not serve, apparently, to innoculate the patient against recurring attacks in modified

* Ph.B., 1930, Dr. Law, 1932, University of Chicago. Foreign Law Section, Law Library of Congress; formerly Chief Attorney, Marketing Laws Survey. Member, Illinois Bar.

† B.A., 1937, LL.B., 1936, LL.M., 1939, George Washington University. Chief Attorney, Marketing Laws Survey. Member, District of Columbia and Michigan Bars.

†† A.B., 1932, University of Nebraska; J.D., 1937, George Washington University. Chief Administrative Attorney, Marketing Laws Survey. Member, District of Columbia and Nebraska Bars.

[1] Schecter Poultry Corp. v. United States, 295 U. S. 495 (1935).

form. The National Automobile Dealers Association, for example, has been trying to secure the blessing of the Federal Trade Commission for a plan designed to establish a little NRA for the automobile industry.[2] Milk control legislation, also, embodies a policy of strict control of competition. The New York milk control act furnishes an excellent illustration. By its terms and under its authority the licensing of dealers going into business after June 1, 1939, is forbidden, unless the regulatory board is satisfied that the issuance of the license is in the public interest.[3] In two states, at least, bills have been introduced but not passed which would limit the number of automobile dealers.[4] Much the same effect is achieved by licensing legislation which requires barbers to have completed a course in histology; plumbers to have had ten years experience or a degree in science from an accredited college; and photographers to be of good moral character and of sound financial integrity. These illustrations might be multiplied a hundredfold.

Just how far a state may go in controlling competitive practices by licensing or otherwise is at the present time highly conjectural. "Business affected with a public interest" may mean one thing under the doctrine of the *Nebbia* case[5] and another under the doctrine of the *Liebmann* case.[6] Again, the term may now be obsolete. One thing, however, seems clear; this type of licensing legislation is strikingly comparable to the "convenience and necessity" theory of governmental control as applied to public utilities. If the trend toward such legislation continues it may well be asked what is to become of individual enterprise. Are we to look forward to ever-increasing restrictions on the right of the individual to enter a business of his own choosing? What are the limits of legitimate licensing legislation?

These problems can be determined only in terms of the effect and extent of legislative control, which in turn must revolve around one's basic philosophy as to the underlying objectives of government. What belongs within the province of proper legislative regulation may mean one thing to one group of men and quite another thing to another. Although to each, government is the means of achieving the greatest good for the greatest number, the fundamental struggle between the two groups centers around more and more *laissez faire* as opposed to more and more governmental supervision. To the former group, too much government inveighs regimentation, dictatorship or cartelization. To the latter, the rules of fair play may be more effectively controlled through governmental umpireship rather than through a self-disciplinary type of control. It is not within the scope of this discussion to attempt to say which of the two concepts is to prevail or which can be offered as a panacea to cure the ills of this troubled world. It is, however, our purpose to point out certain types of legislative restrictions which may operate for or against the achievement of a sounder economy.

[2] *Fed. Trade Comm. Report on the Motor Vehicle Industry,* H. R. Doc. No. 468, 76th Cong., 1st Sess. (1939) 367-368.

[3] N. Y. AGRIC. & MARKETS LAW, art. 21, §258c.

[4] Note, *Legislative Succor for the Motor Car Dealer* (1939) 5 OHIO ST. L. J. 377.

[5] Nebbia v. New York, 291 U. S. 502 (1934).

[6] New State Ice Co. v. Liebmann, 285 U. S. 262 (1932).

Beginning with a few simple licensing statutes in the earliest history of this country, there has evolved a series of progressive restrictions in governmental control of business until today even price-fixing is rather commonplace. Since the turn of the century, state licensing legislation in some form has encompassed virtually every conceivable type of profession, industry, business, trade and occupation.[7] In addition, thousands of municipal ordinances now establish licensing requirements, to say nothing of the numerous limitations imposed upon various callings by villages, townships, counties, park districts, school districts, sanitary districts and other subdivisions of state governments. The Federal Government, too, has set up countless instances of licensing supervision.[8]

Generally speaking, until recent years three broad types of business licensing statutes were commonly employed. In the first classification may be placed licensing for revenue by states and municipalities levying a tax on the privilege of doing business. Secondly, there has been a plethora of licensing legislation for the avowed purpose of protecting public health or safety. Included in this category have been building contractors of various types, restaurants, barber and beauty shops, sellers of firearms and explosives, narcotics, liquor and milk and dairy products. The third classification takes the form of licensing or chartering utility services such as power, light, gas, water, transportation, communications, *etc.*, where regulation is necessary because of the monopolistic nature of the business. Only recently has there appeared a fourth type of licensing legislation designed, as above emphasized, to effectuate the regulation of competitive practises and price policies.

For the purpose of examining the "barrier" implications of licensing legislation, this paper will attempt a breakdown of licensing legislation according to the restrictions imposed upon selected types of business enterprise. Certain types of these statutes clearly operate as barriers within the marketing process. The cumulative effect of others may be equally burdensome. An examination of these and their effects on different types of businesses can be made by dividing them into several categories. Two main classifications conveniently serve this purpose. The first involves the relations of persons to the state and includes licensing *per se;* restrictions as to qualifications, character and fitness; and certain other conditions precedent and subsequent to obtaining and retaining a license to engage in a business, trade or occupation. The second classification involves not only the relation of persons to the state, but more directly the relationship of those in the same business or trade to each other. As such it includes functional limitations; limitations as to the hours or days during which business may be conducted; limitations in the location of a business; and the price-fixing provisions within different types of enterprise.

[7] See, *e.g.*, Index of N. C. CODE (1939) pp. 3143-3145.

[8] Koons, *Growth of Federal Licensing* (1936) 24 GEO. L. J. 293. Municipal activity is covered by McIntire and Rhyne, *Municipal Legislative Barriers to a Free Market, infra* this issue.

Relations of Persons to the State

Licensing Per Se

The right of the individual to enter into and engage in the business, trade or occupation of his choice was in the earliest history of this country considered to be a natural and absolute right. Governmental interference with that right was viewed with grave suspicion by the courts. For that matter, legislative branches of state government showed little disposition to interfere with the unrestricted functioning of individual enterprise. The system of licensing businesses, trades and occupations was confined to relatively few pursuits. Thus in Nebraska, in 1881, the only licensing legislation in effect was that applicable to peddlers, liquor sales and sales of real estate.[9]

In 1885, the New York legislature sought to regulate by licensing the manufacture of cigars in the home. The court was shocked beyond measure by such legislative impertinence. In holding the statute repugnant to the fundamental rights of man, the language of the court clearly reveals the prevalent inhibitions of the time against governmental interference with private initiative:[10]

> Such legislation may invoke one class of rights today and another tomorrow, and if it can be sanctioned under the Constitution, while far removed in time, we will not be far away in practical statesmanship from those ages when governmental prefects supervised the building of houses, the rearing of cattle, the sowing of seed and the reaping of grain, and governmental ordinances regulated the movement and labor of artisans, the rate of wages, the price of food, the diet and clothing of the peoples, and a large range of other affairs long since in all civilized lands regarded as outside of governmental functions. Such governmental interferences disturb the normal adjustments of the social fabric, and usually derange the delicate and complicated machinery of industry and cause a score of ills while attempting the removal of one.

Today, licensing *per se,* or a licensing law enacted under the state's revenue-raising powers providing for merely a two, three or five dollar fee, without more, is generally not open to judicial question. However, the cumulative effect of such legislation, especially as experienced by businesses or industries operating in several states, counties, or cities, may be open to serious economic objections.

Qualifications, Character and Fitness Requirements

Rigid requirements as to qualifications, character and fitness undoubtedly are justified as conditions precedent to the issuance of a license in certain businesses and professions. No exception can be taken to statutes which demand high standards of lawyers, physicians, dentists, nurses and accountants. Knowledge peculiar to such callings is achieved only after thorough education. Their dealings involve a peculiarly personal trust relationship to their clientele and the public must necessarily place complete reliance upon their individual knowledge, judgment and skill. Similar requirements are justifiably applied to the so-called quasi-professional groups, those including osteopaths, neuropaths, chiropodists, veterinarians, mid-

[9] See Index of Neb. Comp. Stat. (1881) p. 783. [10] *In re* Jacobs, 98 N. Y. 98, 114 (1885).

wives, and similar occupations. The courts have shown a clear disposition to sustain licensing requirements of qualifications, character and fitness as applied to such groups, either because of their relationship of trust or because of the primary importance of public health.

These particular requirements, however, when applied to the ordinary trades of barbering, cosmetology, plumbing, building, watchmaking, or photography, frequently assume a more onerous aspect. At least a potential danger arises that many an honest, conscientious man or woman will be deprived of earning a livelihood. Such statutes may readily operate to restrict the number of persons who may engage in a particular occupation, and also lead, in some degree, to the control of competition and price. Whether this result is desirable or undesirable depends upon one's views with relation to our economic society. In any case, an examination of a few statutes establishing these requirements for certain occupations may be profitable.

The licensing of barbers furnishes an excellent illustration. Applicants for a barber's license must have educational qualifications ranging from a knowledge of the English language[11] or a grammar school education[12] to at least two years of high school.[13] In addition, they may be required to have completed a course of instruction in a licensed or approved school of barbering, the instruction to include a certain number of credit hours in some or all of the following subjects: scientific fundamentals of barbering; hygiene; bacteriology; histology of the hair, skin, nails, muscles, nerves; structure of the head, face and neck; elementary chemistry relating to sterilization and antiseptics; diseases of the skin, hair, glands and nails; haircutting; shaving; arranging, dressing, coloring, bleaching and tinting of the hair. The applicant, furthermore, must have served an apprenticeship of from six months[14] to three years,[15] and may also be required to pass satisfactorily an oral, written and practical examination as given by Boards of Barber Examiners, whose qualifications generally are not adequately defined and whose powers, in many instances, are so broad and whose discretion is so wide that they may be exercised in an arbitrary and unreasonable manner. Many such statutes have received judicial sanction on the ground of compatability with public health and welfare.[16] Illustrative of the view taken by many courts is the language of the highest court of North Carolina used in upholding that state's barbering law:[17]

[11] OKLA. STAT. ANN. (1938) tit. 59, §76.

[12] OHIO CODE ANN. (Throckmorton, 1940) §1081-13.

[13] Ky. Laws Sp. Sess. 1938, c. 44, §10.

[14] MICH. COMP. STAT. (Mason, Supp. 1937) §8700-2 (10b).

[15] CONN. GEN. STAT. (Supp. 1935) §1194c.

[16] People v. Stiegler, 160 Misc. 463, 290 N. Y. Supp. 732 (1936); Clark v. State, 169 Miss. 369, 152 So. 820 (1934); State v. Ross, 185 S. C. 472, 194 S. E. 439 (1937); State v. Blocker, 176 Ga. 125, 167 S. E. 298 (1933); Mundell v. Graph, 62 S. D. 631, 256 N. W. 121 (1934); State v. Nolan, 161 Tenn. 293, 30 S. W. (2d) 601 (1930); Gerard v. Smith, 52 S. W. (2d) 347 (Tex. Civ. App. 1932); State v. Wester, 135 Wash. 32, 236 Pac. 790 (1925); State v. Briggs, 45 Ore. 366, 77 Pac. 750 (1904); State v. Zeno, 79 Minn. 80, 81 N. W. 748 (1900).

[17] State v. Lockey, 198 N. C. 551, 557, 152 S. E. 693, 696 (1930), upholding the validity of the Barber's Code, N. C. CODE (Michie, 1939) §§5003 *et seq.* For similar laws see CAL. GEN. LAWS (Deering, 1937) act 665; W. VA. CODE (1937) §§1409(39) *et seq.;* MD. CODE ANN. (Flack, 1939) art. 43, §§304 *et seq.*

We think the regulations reasonable and the whole act in the interest of skill, proficiency, health and sanitation; and brings the barber and barber shop up to a high standard for the protection of the health of the public.

In a few states, the courts have invalidated this type of legislation. The Maryland Barber's Code, for instance, was found to be something more than a measure designed to safeguard the public health:[18]

This trade is neither highly technical nor exceptionally difficult, and its nature is understood by persons, generally; the many regulations found in this act seem to be unnecessary and unreasonable in safeguarding public health or security. . . . This trade has long been recognized; it is one that may not be destroyed, and in which people desiring to engage may not be arbitrarily prevented.

In concluding, the court observed that the obvious purpose of the act was not to protect the public health but to restrict the number of persons entering the trade; and, under the principle "that the police powers of a state could be used only for the welfare of the general public," this attempt to foster a monopoly was found to be repugnant to the Fourteenth Amendment.[19]

The barbering trade offers but one illustration of ordinary occupations which may be subjected to extensive licensing requirements by way of qualifications, character and fitness. A New York statute requires applicants for licenses as master plumbers "to have had not less than ten years experience in the plumbing industry in the United States, except that three years experience in the plumbing industry shall be sufficient together with a technical degree in engineering from a college or university approved by the Regents of the University of the State of New York."[20] In a challenge of the validity of this statute, the petitioner's charge that such "regulation of the right of new people to engage in competition as master plumbers is a Fascist method of industrial control which should be allowed no headway in our Democracy," was answered with the judicial assertion that the statute "merely safeguards" the public interest by providing necessary experience and training as to the required qualifications. With respect to the provision of the act authorizing the licensing authority to call upon the plumbing industry for assistance in the preparation, conduct and rating of the practical, oral and written examinations of persons seeking a plumber's license, the same court said without reservation:[21]

It is most natural and indeed desirable that this Commission be given the right to obtain the views of the plumbing industry in connection with the determination of the proper qualifications of a master plumber.

[18] Schneider v. Duer, 170 Md. 326, 332, 184 Atl. 914, 917 (1936).

[19] Compare the language in People v. Logan, 284 Ill. 83, 86, 119 N. E. 913, 914 (1918): "Three years seems like a long time for learning the trade of a barber, but we cannot say that it is so unreasonably long as to constitute an unreasonable restriction upon the right to engage in the trade."

[20] N. Y. Laws 1936, c. 610.

[21] Benedetto v. Kern, 167 Misc. 831, 837, 4 N. Y. S. (2d) 844, 850 (1938), *aff'd by Mem. Dec.*, 255 App. Div. 753, 7 N. Y. S. (2d) 227 (1938).

No consideration was given to the implications of limiting competition by such means. A more realistic view is presented by the dissent in an earlier New York case of the same judicial temperament:[22]

Taking the act [an earlier similar act] as a whole, it would seem quite apparent that its purpose is to enable the employing plumbers to create a sort of guild or body among themselves into which no one is permitted to enter excepting as he may pass an examination, the requisites of which are not stated, and where his success or failure is to be determined by a Board of which some of their own number are members. . . . It is difficult to see the least resemblance to health regulation in all this.

As late as 1925, an Arkansas court, conceding that its decision was against the weight of authority, refused to uphold a plumbers' licensing ordinance because there was no relation to health regulation in requiring one to become a member of a "favored body" before engaging in a trade.[23]

The changing conceptions of the courts in relation to this problem may best be portrayed by two Washington decisions. In the earlier of the two cases, the court of that state said:[24]

We are not permitted to inquire into the motive of the legislature, and yet, why should a court blindly declare that the public health is involved when all the rest of mankind know full well that the control of the plumbing business by the Board and its licensees is the sole end in view.

Twenty-four years later the same court made this very significant statement:[25]

Courts do not act upon evidence as to what is and what is not so designed to promote the public welfare, but, to the contrary, every such act is presumed to be in the interest of the public welfare if a state of facts might possibly exist which would justify it.

The tide is running toward a more integrated control of trades and professions and the courts show little disposition to check it. Undoubtedly there are advantages in such restrictive legislation, even to the consumer, but it may also lead to the disadvantages of the old mercantilist system which it so closely resembles.

An applicant for a contractor's license in New Mexico must submit a complete statement of the nature of his business and his experience. He must be of good reputation and must never have lost a license by revocation or suspension on any ground that would preclude his being granted a license in New Mexico.[26] The Michigan contractors' licensing law for Detroit[27] requires that the written examination must show

. . . a fair knowledge of the English language including reading, writing, spelling and elementary arithmetic, and an ability to read and interpret plans and specifications, the

[22] People v. Warden of City Prison, 144 N. Y. 529, 543, 39 N. E. 686, 690 (1895).

[23] Replogle v. City of Little Rock, 166 Ark. 617, 267 S. W. 353 (1925).

[24] Richey v. Smith, 42 Wash. 237, 249, 84 Pac. 851, 854 (1906).

[25] City of Tacoma v. Fox, 158 Wash. 325, 331, 290 Pac. 1010, 1012 (1930).

[26] N. M. Laws 1939, c. 197. The Comptroller General of the United States has held that the United States Government was not precluded from accepting bids from New Mexico contractors not licensed under this law. (1940) 19 Op. Compt. Gen. 735.

[27] Mich. Laws 1939, No. 311, §8690-25.

obligations of a residential building contractor to the public and his principal, and the provisions of the Michigan statute relating to the regulating and licensing of residential building contractors.

This law carries, also, the curious provision that the required recommendations by two citizens of the state must be accompanied by a "legal description of at least one parcel of real estate" owned by the persons recommending the applicant. Thus it is made certain that local property owners control the induction of new entrants into the trade.

In Maryland a statute was invalidated which set up machinery for the purpose "of issuing licenses and examining into the qualifications and capabilities of all persons engaging in or desiring to engage in the business of paper-hanging."[28] The court declared the act to be an unfair and unjust interference with the "common right of engaging in an ordinary trade." Such a legislative measure, said the court, had no substantial relation to the public health or safety.[29]

On the other hand, a North Carolina statute providing that every person desiring to engage in the practice of photography must first fully satisfy a Board of Photographic Examiners as to his "technical qualifications, business record and moral character,"[30] was sustained on the ground that photography requires skill and involves the use of chemicals and other combustible materials to such a degree that the public interest is sufficient to warrant adoption of the act.[31]

There has as yet been no determination of the legality of the Wisconsin watchmaker's statute which provides that no person can engage in the trade of watchmaking, watch repairing or watch reconditioning without first satisfying a Board of Watchmakers as to his theoretical knowledge of watch construction as well as to his technical ability in handling tools and certain other mechanical devices.[32]

Recently a new type of licensing legislation directed at automobile dealers has been adopted in four states.[33] Because this legislation was designed to cope with the chaotic economic situation existing among automobile retailers, it will be discussed later. Suffice it to say here that under all four statutes, a license may be denied upon proof of unfitness or bad business repute of the applicant.

It should be observed that in most of these statutes, rather wide discretionary authority is placed in the hands of an administrative agency, frequently composed of members of the industry, particularly for the purpose of determining character

[28] Md. Laws 1935, c. 377.

[29] Dasch v. Jackson, 170 Md. 251, 183 Atl. 534 (1936).

[30] N. C. Code Ann. (Michie, 1939) §§7007 *et seq.*

[31] State v. Lawrence, 213 N. C. 674, 197 S. E. 586 (1938), *cert. denied,* 305 U. S. 638 (1938).

[32] Wis. Stat. (1939) c. 125.

[33] Wis. Stat. (1939) §218.01; Ohio Code Ann. (Throckmorton, 1940) §6302-1; Neb. Comp. Stat. (Supp. 1939) §60-901; Iowa Code (1939) §5039.01. Pennsylvania adopted a similar act, Pa. Stat. Ann. (Purdon, 1937) §1301, which was invalidated before it went into effect. Heinel Motors, Inc. v. Teefy, 295 Commonwealth Docket (Dauphin County Ct. 1937). Two Texas cities, Dallas and Houston, have licensing ordinances, set up under Tex. Laws 1937, tit. 28, c. 6, which achieve the same type of control. *Motor Vehicle Dealer Licensing Laws in Force* (Auto Mfters. Ass'n, 1938).

and fitness. Such terms as "bad business repute," "unfitness," "competent and trustworthy," *etc.*, are "weasel" words subject to varying interpretations. Irrespective of the merits of allowing a wide range of latitude in administrative control, it is apparent that discretionary power as indefinite as that illustrated in some of these statutes is potentially open to abuse especially in cases where members of a board may be interested in restricting the number of their competitors to the absolute minimum. It is, of course, true that frequently the statutes provide for review by a court of competent jurisdiction. But such safeguards do not remove the infirmity attaching to an unlawful delegation of authority.

"Bad business repute" and "good character and reputation" have received judicial sanction by the Supreme Court of the United States as terms sufficiently definite to satisfy the Fourteenth Amendment.[34] There are state court decisions, however, which have disapproved the delegation of authority to determine "competent and trustworthy,"[35] "unprofessional conduct,"[36] and experience, ability and general reputation for integrity.[37] Certain standards such as "good moral character" and "unfair competition," have, through years of definition, come to have a comparatively standardized meaning.[38] Whether "bad business repute" and "good character and reputation" fall within this latter category may be open to some doubt. In any event, the discretion allowed the administrator in making such determinations may conceivably result in his limiting the number of persons who may engage in a particular business in a particular state.

Other Conditions Precedent

Applicants for licenses to participate in various business activities may also be required to meet burdensome bonding or financial requirements. Here, again, such requirements may serve an excellent purpose when applied to certain businesses. At the same time, these statutory provisions may result in closing the avenues of business to small operators, many of whom are unable, because of lack of capital, to meet rigid prerequisites of this character.

An illustration of this type of restrictive licensing is found in the Louisiana commodity control statute requiring all applicants for wholesale farm produce dealers licenses to deposit with the Commissioner of Agriculture a $2,000 bond to insure faithful performance and "to secure the payment of all moneys or accounts owed by the dealer in farm produce to any person, firm, exchange, corporation or association arising out of the conduct of the business of such dealers in farm produce."[39] This law is in many respects similar to the bonding requirements contained in the 21 milk control acts as well as those contained in many of the other commodity

[34] Hall v. Geiger-Jones Co., 242 U. S. 539 (1917); Gundling v. Chicago, 177 U. S. 183 (1900). *Cf.* Mutual Film Corporation v. Ohio Industrial Commission, 236 U. S. 230 (1915).

[35] Harmon v. State, 66 Ohio St. 249, 64 N. E. 117 (1902); Toledo v. Winters, 21 Ohio Dec. 171, 11 Ohio C. C. (N. S.) 577 (1910).

[36] Mathews v. Murphy, 23 Ky. 750, 63 S. W. 785 (1901).

[37] People v. Beckman & Co., 347 Ill. 92, 179 N. E. 435 (1932).

[38] FREUND, ADMINISTRATIVE POWERS OVER PERSONS AND PROPERTY (1928) 276.

[39] La. Laws 1932, act 237, as amended Laws 1934, act 176.

control laws dealing with such articles as fruit, fuel and agricultural products.[40] All of the statutes contain provisions requiring applicants, before licenses will issue, to produce financial statements and to satisfy fully the commissioners or members of the boards as to their financial position and integrity as well as to their possession of adequate and sufficient physical facilities and machinery properly to carry on and conduct their respective businesses.[41]

Building contractors frequently may be required by law to post a bond for the satisfactory performance of contracts. In many instances, a small contractor may be precluded from bidding on construction projects owing to financial inability to meet this requirement of the licensing statute. Automobile dealers, under the newer type of licensing control mentioned above, must meet various financial requirements. Wisconsin, Ohio and Iowa specifically require the applicant to submit a financial statement.[42]

These automobile dealer statutes also serve to illustrate another restriction of this character which takes the form of limiting the number of persons who may engage in a particular business, thus drawing a parallel to the "convenience and necessity" theory of licensing. Comparable also in this respect is the New York milk control act[43] which provides that the commissioner shall issue no license unless he is satisfied that "the issuance of the license will not tend to destroy competition in a market already adequately served, and that the issuance of the license is *in the public interest*"; and under no circumstances can the commissioner issue a milk dealer's license to any person not now engaged in the business as a milk dealer.

Financial and bonding requirements for licenses have been generally sustained by the courts as a valid exercise of the state's police power. A New York court went so far as to restrain a milk dealer from buying milk from producers for resale without executing a bond or furnishing security as required by the act, notwithstanding the fact that the producers with whom the dealer had regularly dealt for many years did not want such protection.[44] On the other hand, a Michigan statute which called for the filing of a $1,000 bond by a contractor suggested to the court of that state too much paternalism in ordinary business relations and was accordingly invalidated.[45]

[40] See *State Milk & Dairy Legislation* (W.P.A. Marketing Laws Survey, 1939); see also TEX. STAT. (Vernon, Supp. 1938) art. 576a (citrus fruit); CAL. GEN. LAWS (Deering, 1937) act 2666 (foodstuffs); COLO. STAT. ANN. (Michie, Supp. 1939) c. 110; CONN. GEN. STAT. (1930) §2306; N. M. STAT. ANN. (Courtright, 1929) §§24-101 to 24-109 (coal, oil and fuel); CAL. AGRIC. CODE (Deering, Supp. 1939) §§1300.13 *et seq.;* GA. CODE ANN. (Park *et al.*, 1936) §§5.211 *et seq.;* Idaho Laws 1935, c. 113 (agricultural commodities).

[41] FLA. COMP. GEN. LAWS (Supp. 1940) §3219 (46) (2, 3, 4); IND. STAT. ANN. (Burns, Supp. 1939) §15-1707(A); La. Laws 1932, act 237, as amended Laws 1934, act 176; N. Y. AGRIC. & MARKETS LAW, art. 21, §258c; PA. STAT. ANN. (Purdon, Supp. 1939) §700j-403; WIS. STAT. (1939) §100.03.

[42] Note 33, *supra.*

[43] N. Y. AGRIC. & MARKETS LAW, art. 21, §258c.

[44] Ten Eyck v. Eastern Farm Products, 160 Misc. 402, 290 N. Y. Supp. 475 (1936), *aff'd*, 249 App. Div. 891, 292 N. Y. Supp. 787 (1937). See also, *Ex parte* Welling, 27 Cal. App. (2d) 367, 80 P. (2d) 1027 (1938); Com. *ex rel.* Margiotti v. Ortwein, 132 Pa. Super. 166, 220 Atl. 859 (1938).

[45] Harrigan & Reid Co. v. Burton, 224 Mich. 564, 195 N. W. 60 (1923); but see City of Milwaukee v. Rissling, 184 Wis. 517, 199 N. W. 61 (1924).

This type of statute, again, vests a great amount of discretionary authority in an administrative board and some of these laws have been invalidated on the ground of improper delegation. The Louisiana court in declaring its produce act[46] invalid held[47] that a statute

> . . . which undertakes to regulate a lawful business or occupation by conferring upon a designated officer, or commission, or board, the authority, within his or its judgment or ["sound"] discretion, to grant or to withhold a license or permit to engage in the business or occupation, and which does not prescribe a rule or standard to which all persons similarly situated may conform, constitutes a denial of the equal protection of the laws.

A more current view, however, is expressed in the words of the New York Court of Appeals in upholding the validity of a similar provision in the New York milk control law:[48]

> The condition that the Commissioner shall be satisfied that the applicant is "qualified by character, experience, financial responsibility and equipment to properly conduct the proposed business" is not fairly open to that criticism. True, the Legislature has not attempted to create a rule of thumb by which a man's character, experience, financial responsibility and equipment may be measured. It is difficult to conceive of a rule of thumb which could be formulated. None the less, it has created a standard by which such qualifications can be measured. They must be sufficient "to properly conduct the proposed business." *All that is left to the Commissioner is to weigh the evidence and determine the fact.*

Conditions Subsequent

Closely related to conditions precedent are conditions subsequent. In order to engage in trades or occupations of their choice, applicants for licenses must not only comply with many rigid restrictions for permission to enter into a particular occupation, but must satisfy many limitations equally burdensome in order to remain in that occupation. Such subsequent restrictions may be of a negative or a positive character.

Restrictions of a negative character take various forms. One of the most important is the type of limitation which provides for the suspension or revocation of a permit for failure to comply with fair trade practices prescribed for a particular trade or occupation. Unfair practices provisions usually prohibit, among other things, "loss leader" sales, gifts or other selling practices that result in sales below cost. Such restrictions on sales may serve to protect the small businessman against unfair competitive practices directed against him by larger businesses of the same type as his. These provisions, however, are frequently coupled with others of an indefinite character, with wide discretionary authority to suspend or revoke licenses for violation. A small operator may find himself faced with a serious problem in

[46] Note 39, *supra*.

[47] State v. Chisesi, 187 La. 675, 693, 175 So. 453, 459 (1937).

[48] Matter of Elite Dairy Products v. Ten Eyck, 271 N. Y. 488, 495, 3 N. E. (2d) 606, 609 (1936) (italics supplied). See also, Matter of Crowley's Milk Co. v. Ten Eyck, 270 N. Y. 328, 1 N. E. (2d) 119 (1936); Sheffield Farms v. Ten Eyck, 252 App. Div. 825, 299 N. Y. Supp. 340 (1937); Highland Farms Dairy v. Agnew, 300 U. S. 608 (1937).

this connection. Often the only way for him to meet the competition of his more powerful competitor is to sell at a slightly lower price or to offer certain other inducements to attract customers. Owing to lower operating costs, he may well be able to afford such concessions and still make a profit. Is he to be required to sell at the same price as his more elaborate competitor who must meet high rentals, large payrolls and high advertising costs? Under a legislative provision of this nature he is. This type of control is a far cry from the concept of individual enterprise.

By way of illustration, there are within this category restrictions directed against trade practices. Thus the Wisconsin watchmakers statute empowers the Board of Watchmakers to suspend or revoke a license when it is satisfied that the holder of a license is grossly incompetent, or is guilty of immoral or unethical conduct. Immoral or unethical conduct is defined[49] as

> conduct of a character likely to mislead, deceive or defraud the public; advertising of any character in which untruthful or misleading statements are made; advertising of prices on watch repairing, or the giving of watch glasses, crystals or of any other watch parts, gratis, or at less than cost, in order to advertise or increase the watch repair business. . . .

The Wisconsin automobile dealers license law includes as a ground for revocation, engaging in "unconscionable or unfair trade practices"; these practices are defined to embrace the making of such consistent and material allowances on used car "trade-ins" over a period of time as would tend to affect competition adversely, demoralize the industry or injure consumers.[50] In Nebraska, an automobile dealer's license may be suspended or revoked for the defrauding of customers; intentional publication of misleading or inaccurate advertising; violation of state or federal laws relating to fair or unfair trade practices; wilful or habitual allowance of excessive trade-ins for the purpose of lessening competition or destroying a competitor's business; violation of the antidiscrimination laws; discrimination between purchasers with respect to the furnishing of services or facilities or the granting of discounts or rebates.[51]

Falling within this category of negative restrictions are also those which are primarily directed against the entry of the licensee's products or services into the market. While the purposes for which legislation of this character is enacted are in many instances laudable and essential for the protection of the public health, nevertheless, the total effect of all such restrictions may be so great that in operation the purposes for which they were enacted are defeated. The many state grading, labelling, quarantine and inspection laws are examples of this type of restriction. That milk should be rigidly inspected is not only desirable but imperative. Yet, remembering that each such inspection means a corresponding boost in the price the consumer will ultimately pay, it is questionable whether the public health requires an equally rigorous inspection of the same can of milk as it passes from

[49] WIS. STAT. (1939) c. 125.
[50] *Id.* c. 218.
[51] NEB. COMP. STAT. (Supp. 1939) §60-901.

milk shed area to milk shed area, from county to county and from state to state as is required by numerous state milk inspection laws.

Of the same character, and in operation having a similar effect, are the myriad of detailed and exacting restrictions imposed upon builders and contractors as respects foundations, outer-walls, floors, partitions, shafts, courts, stairways, halls, roofs, and skylights. Lumber, cement, steel, concrete and fixtures to be installed must meet equally rigid specifications under each of the building codes adopted by the states and under many more ordinances adopted by each of the municipalities within the states. That these measures bear a close relationship to public health and safety no one can deny. Not so clear, however, are the considerations of public health and safety that require by legislation in many cities the revocation or suspension of a contractor's license for installing in private homes plumbing fixtures of the same type and character as those which have been installed in the palatial structure housing the United States Department of Justice.[52]

A witness in testifying at the hearings before the Temporary National Economic Committee with respect to the legislative delays in removing many of the marketing barriers from the building and construction codes, said:[53]

> Naturally, when you have a building code where somebody has in the past set up for himself a special privilege, and that special privilege is being removed, he resents it; he is trying to keep his position . . . and he uses influence of every kind that he can to persuade those that are in charge of adopting the code to keep the old privilege intact.

Thus, the Chicago Code, on advice of the plaster contractors and the building trades' union rather than upon the recommendations made by technical experts on the basis of scientific studies and surveys, still systematically favors the use of lathes and plaster over the use of plaster boards, insulation boards or hard fiber boards.[54] And, for similar reasons, the New York building code requires 12 inch plaster walls that will withstand a fire test for 4 hours, while walls made of glass are required to withstand a fire test of only 5 minutes.[55] These examples can be multiplied, but the whole question is best presented in the words of a member of the Temporary National Economic Committee:[56] "I think we all agree that building codes are a distinct hindrance to the use of improved building materials."

Typical of restrictions against services is an ordinance adopted by the city of Roanoke, Virginia,[57] regulating the practice of barbering. In addition to all of the other health measures in effect in the state and locally, providing for enforcement through fine and imprisonment of the many health and sanitary regulations covering all types of trades, businesses and occupations, this ordinance makes possible the suspension or revocation of a permit or license if the barber fails to, report to the health authorities the name and address of any employee engaged as a barber whom

[52] ARNOLD, THE BOTTLENECKS OF BUSINESS (1940) 43.
[53] *Hearings before the Temporary National Economic Committee*, 76th Cong., 2d Sess. (1940) No. 11, at 5327.
[54] Edwards, *Trade Barriers Created by Business* (1940) 16 IND. L. J. 169, 173.
[55] *T. N. E. C. Hearings, supra* note 53.
[56] *Id.* at 5335.
[57] Ordinance adopted by City Council on July 15, 1932.

he knows or suspects to be suffering from an infectious disease, however slight; sterilize after each and every separate use thereof all razors, brushes, combs, scissors, tweezers and all other implements that may come in contact with the skin of a customer; use a freshly laundered towel, hair-gown or other cloth for each customer; change the head-rest of each barber's chair with a freshly laundered towel or clean sheet of paper before its new occupancy; wash his hands thoroughly with soap and hot water and rinse and immerse them in an approved disinfectant before attending any person; wear a freshly laundered (washable) outer coat when attending each customer. And in addition to other exacting health, sanitary, light, air and ventilation requirements, the barber may also be barred from engaging in the trade if he uses powder-puffs, sponges, neck-dusters, soap, shaving cups, finger bowls and all such other utensils in common with or for more than one person.

There are also other restrictions affecting the entry of products and services, but these are more in the nature of conditions precedent, conditioning *ab initio* the entry of goods, commodities and services into the state market. These are the restrictions commonly referred to as interstate trade barriers, their purpose being not to limit functionally the marketing of products in intrastate and interurban commerce—residents and non-residents being treated alike—but to act as a geographic limitation to restrict the marketing of products and services coming from other states, to the advantage of local residents, products and businesses.

Finally, there are within this group of negative restrictions those which are directed against personal conduct, character and behavior, some of which are particularly difficult to enforce. In North Carolina, the Board of Tile Contractors is authorized to suspend or revoke a license when it is satisfied that the licensee is guilty "of gross negligence, incompetency or inefficiency in carrying on the business of tile contracting."[58] Still more intricate are state laws which provide that a barber's license may be revoked on grounds of drunkenness, or habitual addiction to the use of drugs.[59] Some barbers are inclined to subject their patrons to a conversational barrage. Why not legislate against this baneful conduct also? Such legislation would be susceptible to enforcement with about the same degree of success. Who is to determine when a barber is drunk? May he get drunk after hours or is the sanctity of his own home to be violated? In North Carolina, a photographer may be prevented from earning a livelihood if he is found guilty of any crime, however trivial, so long as it involves his moral turpitude.[60] In these instances the legislature would have done well to appropriate money for a morals squad to be attached to the office of the administrator of the act.

Of the affirmative type of conditions subsequent are the special industrial or occupational taxes, other than the general revenue-raising measures, imposed upon licensees for the privileges extended to them by the state of engaging in certain lines of business. In New Mexico, barber shops, dry-cleaners, beauty parlors and

[58] N. C. CODE ANN. (Michie, 1939) §§5168 (ggg)-(lll).
[59] See the statutory citations *supra* notes 11-15.
[60] N. C. CODE ANN. (Michie, 1939) §§7007 (1)-7007 (29).

retail oil stations are required to pay annually a sum equal to two percent of their gross receipts for the franchise of doing business.[61] A Louisiana statute provides for an annual privilege tax on all persons, individuals or corporate, engaged in the laundry and dry-cleaning business, except those persons who themselves actually perform manual labor in the plants.[62] This exception was upheld where an individual operating under a trade name worked daily in his cleaning establishment, using his hands and machinery, even though he was assisted by two men and a woman.[63] But the exception was held not to apply to a laundry and dry-cleaning company employing labor, although the owners themselves did call for and deliver clothes for the business.[64] The court in the latter case, basing its authority solely upon the decision of the Supreme Court of the United States in the *Quong Wing* case,[65] held that a discrimination in favor of one who labors with his hands is not unreasonable or arbitrary. But the California statute involved in the Supreme Court determination, although somewhat similar, discriminated for an opposite purpose; large powerful steam laundries were to be protected by the discriminatory legislation against the encroachments upon their businesses by small Chinese hand laundries.

RELATION OF PERSONS IN BUSINESS TO EACH OTHER

Functional Limitations

Conditions precedent and subsequent involve primarily the state on the one hand and, on the other, the persons seeking the right from the state to engage and remain in the business, trade or occupation of their choice. The remaining restrictions are of a more collateral character affecting not only the relationship of these persons to the state but the relationship of those in the same business to each other. First to be considered in this group are the functional limitations tending to restrict and delimit, in this age of over-specialization and occupational disintegration, the scope of individual activity within the occupational classifications. Among the functional limitations there are four types of restrictions: first, those which become restrictive through too narrow a definition of the sphere of the business, trade, or occupation; second, those which become restrictive because of too great a breadth of such a definition; third, those which restrict by separating knowledge and scientific learning from unlicensed management and control; and, fourth, those restrictions which are directed against the offering of incidental services.

Within the first type are such provisions as those contained in the milk control laws empowering their respective boards to attach such limitations to each license as they may deem necessary in restricting the licensee's sphere of activity. In New York, the licensee may be confined in his dealings to a single product or a single type of milk, such as surplus, fluid or dry milk, and may be confined to certain specific functional methods of production, handling, transportation, sales or dis-

[61] N. M. Laws 1939, c. 94, §1.

[62] LA. GEN. STAT. (Dart, 1939)' §§8612 *et seq.;* see also LA. CONST. (1921) Art. 10, §8.

[63] State v. Chicago Hat Works, 174 La. 814, 141 So. 844 (1932).

[64] White Cleaners & Dyers v. Hughes, 7 F. Supp. 1017 (W. D. La. 1934).

[65] Quong Wing v. Kirkendall, 223 U. S. 59 (1912).

tribution.[66] Also within this group are provisions like a Michigan law prohibiting other than registered pharmacists from selling epsom salts even though the salts comply with all pure food regulations and are sold in package form prepared by proper and duly licensed pharmaceutical laboratories; the laws in 39 states requiring one to obtain a registered pharmacist's certificate in order to sell iodine; the Indiana law providing that no one but a registered druggist may sell a bottle of witch-hazel; the laws in eight states prohibiting the sale of peroxide of hydrogen in places other than registered pharmacies; the New York statute to the effect that Ex-Lax may be sold only through pharmacies duly registered in the state; and the Illinois provision imposing a similar prohibition on the sale of bicarbonate of soda.[67]

Another type of restriction within this category of narrowly defined occupations is found in a Colorado statute providing that food may be served and sold for consumption only on premises licensed as restaurants. Restaurant is defined as[68]

> an establishment provided with special space and accommodations where . . . meals are habitually furnished to guests, or a place where food is prepared for human consumption . . . and whose principal business is the sale of meals and in which room nothing is sold excepting meals, food, drink and tobaccos. Any establishment connected with any business whatsoever . . . where any business is conducted excepting the sale of meals, foods, drinks and tobaccos, or hotel business, is hereby declared not to be a restaurant.

In a suit to test the constitutionality of this act brought by a number of drug, department, and five and ten cents stores, for many years engaged in the business of dispensing soft drinks, ice cream, sandwiches and short orders, the federal district court for Colorado[69] held that more than sufficient evidence had been introduced to establish that restaurants as defined have a substantial relation to the public health. By separating the restaurant business from other businesses within a store, said the court,

> the room in which food is served . . . despite the opinions of experts to the contrary . . . can more readily be kept clean and sanitary; it can be kept free from dust and germ carrying flies; and as a less number of persons will enter the room than will enter the general business establishment there will be less of sneezing and coughing therein which all the experts admit may contaminate food. Persons entering a dining room are more apt to be careful of the welfare of others than they would in a general business establishment.

On this theory, the court found that this classification of businesses was neither unreasonable nor arbitrary, and therefore not in violation of the state or federal constitutions. The decision was upheld *per curiam* by the Supreme Court of the United States.[70]

[66] See *State Milk and Dairy Legislation* (W.P.A. Marketing Laws Survey, 1939).

[67] See analysis of laws pertaining to the sale of pharmaceutical products in Inst. of Distribution, *Retailers Manual of Taxes and Regulations* (ed. 1940-41). [68] COLO. STAT. ANN. (1935) c. 81, §14.

[69] S. H. Kress & Co. v. Johnson, 16 F. Supp. 5, 7 (D. Colo. 1936).

[70] 299 U. S. 511 (1936). This Colorado enactment, representing one form of restriction on integration of distribution lines, is discussed in Cook, *Legislative Restrictions on Marketing Integration*, *infra* this issue.

A similar type of restriction is imposed on the sale of electrical appliances in Oklahoma. In interpreting a provision of that state's Corporation Act,[71] requiring all public service corporations to confine themselves strictly to transaction of the business of supplying the services as defined, and forbidding them to engage, directly or indirectly, in incidental lines of business in connection with their principal activity, the Attorney General of Oklahoma held that an electric light and power company cannot lawfully buy or sell electric irons, electric fans and electric refrigerators.[72]

Within the group of functional limitations arising through too broad a definition of the occupation are legislative devices such as the regulation attempted by the Oregon legislature, making it a crime to practice the profession of cosmetic therapy as defined without first obtaining a certificate of registration from the State Board of Examiners. Cosmetic therapy was defined by the act[73] to be

> the application of the hands or of mechanical or electrical apparatus with or without cosmetic preparations, tonics, lotions, creams or clays, to massage, cleanse, stimulate, manipulate, exercise or otherwise improve or beautify the scalp, face, neck, shoulders, arms or upper part of the body, removing superfluous hair, manicuring the nails of any person, male or female, and to arrange, dress, curl, wave, cleanse, cut, singe, bleach, color or similarly treat the hair of any female.

In Illinois the legislature sought to achieve a similar result by requiring cosmetologists to obtain barber's licenses in addition to the license already obtained by them for the practice of cosmetology. This was achieved by withdrawing the occupation of hair cutting and trimming from the definition of "beauty culturist" in a statute[74] defining that practice.

This type of legislation has generally met with judicial disapproval. The Oregon statute was successfully challenged by a number of hairdressers who earned their livelihood solely by hairdressing without engaging in any other practices of cosmetic therapy. Invalidation was placed on the ground that the statute arbitrarily grouped together different and unrelated callings and professions and forbade citizens from following one of them without qualifying in all others. The federal court emphasized that under the provisions of the act one might be an expert in one of the callings specified and yet be prohibited from earning a living thereby unless, in the judgment of the Board of Examiners, he was qualified to practice all of the other callings in which he might not be in the least interested.[75] As a result of this decision, the Oregon law now provides for four classes of operators—hairdressers, cosmetologists, electrologists and permanent wavers—and for the issuance of a separate license to each.[76] The Illinois act was also declared invalid,[77]

[71] OKLA. STAT. (Harlow, 1936) §§9725, 9726.

[72] OP. OKLA. ATTY. GEN., Aug. 1, 1935. Contrast the Kansas judicial attitude toward a similar statute of that state, discussed in Cook, *supra* note 70.

[73] Ore. Laws 1925, c. 75.

[74] Ill. Laws 1929, p. 194, §18.

[75] Baker v. Daly, 15 F. (2d) 881 (D. Ore. 1926).

[76] ORE. CODE ANN. (1930) §68-704. Other statutes make similar provision for the division and separation of functions. CAL. GEN. LAWS (Deering, 1939) act 1755; N. M. STAT. ANN. (Courtright, Supp. 1938) §§123-102-123-104; WIS. STAT. (1939) §§159.01-159.16.

[77] Banghart v. Walsh, 339 Ill. 132, 140, 171 N. E. 154, 157 (1930).

the restrictions having been found to be totally unrelated to the public health or welfare. By this act, the Illinois court held, the legislature attempted to require persons desiring to engage solely in cutting and trimming women's hair "to spend 1,248 hours in a school or college of barbering and two and one half years as an apprentice in a barber shop learning to shave men and trim their whiskers." Though a similar view was expressed by the Supreme Court of Minnesota,[78] its present law[79] now reads:

anyone or any combination of the following practices when done upon the head and neck for cosmetic purposes . . . constitutes the practice of barbering within the meaning of the act: to shave, trim the beard, cut or bob the hair of any persons of either sex. . . .

This is exactly the type of statute which the Oregon legislature sought to avoid after the decision in the *Baker* case.

Then, there are the many licensing statutes covering contractors, plumbers and others engaged in the building trades or professions which are defined so broadly that one engaging only in building houses must know how to build sewers, highways, skyscrapers and bridges. Engineers specializing in electrical or other fields may be required to show proficiency as sanitary engineers, *etc.* The New Mexico contractors' law[80] defines contractor to include persons

other than those engaged in highway or railroad construction, who either for a fixed sum, price, fee, percentage or other compensation, other than wages, undertakes . . . to construct, alter, repair, add to or improve any building, excavation or other structure, project or improvement other than to personalty. . . .

Exceptions are provided for in this act, but the general definition still covers almost every type of contracting. In Illinois a bill was introduced in the state legislature to compel licensing of painters and to prohibit any painting, even of one's own kitchen, except by licensed painters. Although the bill did not pass it is illustrative of the type of statutes countenanced by legislative control through so broad a definition of the scope of occupational classifications.[81]

In the third type of functional limitation—the restriction seeking to prevent control of knowledge and scientific experience by unlicensed management or ownership—is a New York statute[82] which requires that

every pharmacy shall be owned by a licensed pharmacist, and every drug-store shall be owned by a licensed druggist; and no copartnership shall own a pharmacy unless all the partners are licensed pharmacists, and no copartnership shall own a drug-store unless all the partners are licensed druggists. . . .

Similar statutes have been enacted in several states, and upheld by the lower courts in those jurisdictions[83] on the theory that corporations are generally forbidden to

[78] Johnson v. Ervin, 205 Minn. 84, 285 N. W. 77 (1939); see also Keith v. State, 112 Kan. 834, 212 Pac. 871 (1923); Lane v. State, 120 Neb. 302, 232 N. W. 96 (1930); *cf.* State v. Leftwich, 142 Wash. 329, 253 Pac. 448 (1927).

[79] MINN. STAT. (Mason, 1940) §5846-2.

[80] N. M. Laws 1939, c. 197.

[81] *T. N. E. C. Hearings, supra* note 53, No. 11, at 5255.

[82] N. Y. EDUC. LAW, art. 51, §1354 (2).

[83] *In re* Hauges, 140 Misc. 811, 252 N. Y. Supp. 81 (1931); Liggett v. Baldridge, 22 F. (2d) 993 (E. D. Pa. 1927).

engage in the practice of the learned professions. These courts argue that no one today would question the reasonableness of a statute requiring practicing physicians to be licensed by the state. In the words of a New York court:[84]

> Can it not be said with equal reason that a license should be required of the proprietor of a pharmacy who is responsible for quality and potency of the drugs and chemicals which the physician prescribes to effect a cure? Is it not reasonable that the State should have some control over the man whose responsibility it is to employ men and women of expert knowledge to compound the prescriptions of a physician? If we license the physician, should we not license him who is largely responsible for putting the physician's advice into effect?

But the view followed by most courts[85] was expressed by Mr. Justice Sutherland[86] in holding a similar Pennsylvania statute[87] invalid on the ground that the act created unreasonable and unnecessary restrictions upon private business, public interest being already amply protected by the laws requiring that only registered pharmacists can compound prescriptions and by the stringent provisions preventing the possession or sale of any impure drug or any drug below the standard of strength, quality and purity as determined by the recognized pharmacopeia of the United States. It was argued, therefore, that mere stock ownership in a corporation owning and operating a drug-store could have no real or substantial relation to the public health.

Although the proponents of this type of legislation were unsuccessful in their attempt to protect the registered druggists and pharmacists from the encroaching chain drug companies, the proponents of legislation to protect the optometrists have been successful in achieving these limitations, not so much through legislation as by judicial interpretation of the existing optometry statutes. In Philadelphia, owners of a certain department store, not licensed to practice optometry, were restrained from leasing, renting or operating in any manner whatsoever an optical or optometry unit within the store, even though the opticians and optometrists employed by the store had fully complied with all laws regulating the practice of optometry.[88] On the theory that optometry is a profession, the court argued that all rules applicable to professions should apply, saying:

> . . . a licensed practitioner of a profession may not lawfully practice his profession among the public as the servant of an unlicensed person or a corporation. . . . A corporation as such cannot possess the personal qualities required of a practitioner of a profession. . . . The learning and the ethical standards required for that work, and the trust and confi-

[84] *In re* Hauges, *supra* note 83, at 814, 252 N. Y. Supp. at 85.

[85] Pratter v. Lascoff, 261 N. Y. 509, 185 N. E. 716 (1933); State v. Peoples Drug Stores, 36 Del. 120, 172 Atl. 258 (1934). For application of such laws to dentists, see Iowa v. Bailey Dental Co., 211 Iowa 781, 234 N. W. 260 (1931); Painless Parker Dentists v. Bd. of Dental Examiners, 216 Cal. 285, 14 P. (2d) 67 (1932).

[86] Liggett v. Baldridge, 278 U. S. 105 (1928).

[87] PA. STAT. (Supp. 1928) §§9377a-1, 9377a-2.

[88] Neill v. Gimbel Bros. Dept. Store, 330 Pa. 213, 219-220, 199 Atl. 178, 181-182 (1938); see McMurdo v. Getter, 298 Mass. 363, 10 N. E. (2d) 139 (1937). See also Seifert v. Buhl Optical Co., 276 Mich. 692, 268 N. W. 784 (1936); Beck v. Goldman, 142 Kan. 881, 51 P. (2d) 995 (1935); State v. Kindy Optical Co., 216 Iowa 1157, 248 N. W. 332 (1933); Eisenmuth v. Buhl Optical Co., 115 W. Va. 776, 178 S. E. 695 (1934).

dence reposed in optometrists by those who employ them, cannot be dismissed as negligible or as not transcending the requirements of an ordinary trade.

On the other hand, a similar Missouri statute was interpreted to cover only persons who practiced either on their own behalf or as employees of another, and not persons operating through the agency of properly licensed optometrists.[89] Adhering to the doctrine established by the Supreme Court of the United States in the *Liggett* case, the Missouri and other courts[90] have proceeded on the basis that, though the science of optometry may require much preparation and skill, it is not one of the learned professions and certainly not more learned than the profession of druggists and pharmacists. The contention is pressed that there should be no protection given to optometrists except that which may apply to any ordinary business, trade or occupation. The courts holding this view have considered, but have declined to adopt, the doctrine of agency. It is immaterial, they argue, whether licensed optometrists practice the profession on their own behalf or whether they are employed by other optometrists, by non-optometrists or by corporations, the sole legislative intent being that no person shall be examined or have glasses prescribed or prescriptions filled by one unless he is duly licensed as required by statute. Nonetheless, the trend of the decisions in the optometry cases, even without legislative sanction,[91] appears to be in the direction of the decision rendered in the *Neill* case, and away from that in the *Liggett* case, on the ground that the public welfare requires the practice of optometry to be kept on a high plane of professional ethics, standards and scientific learning. That a greater public interest is more manifest in the protection necessary to the practice of optometry is hardly tenable, if for no other reason than that an error, however slight, committed by an optometrist can be corrected, whereas one committed by a druggist may be fatal. The optometrists, however, are being blessed by the courts with protection of professional status, while the business of the druggist or pharmacist continues to be considered as just another ordinary trade.

The last type of functional limitation outlined above is that which is directed against certain business practices. A New York court, in construing the scope and application of the New York insurance laws, held not to be a contract of insurance a watchmaking company's agreement with each customer to replace a watch of like character if the watch purchased was lost through theft or burglary.[92] Contrariwise, an Ohio court held that an auto supply company in that state must comply with all of the licensing laws applicable to insurance when it engages in a

[89] State v. Gate City Optical Co., 339 Mo. 427, 97 S. W. (2d) 89 (1936).

[90] Dvorine v. Castleburg Jewelry Co., 170 Md. 661, 185 Atl. 562 (1936); Jaeckle v. L. Bamberger & Co., 119 N. J. Eq. 126, 181 Atl. 181 (1935) *aff'd*, 120 N. J. Eq. 201, 184 Atl. 520 (1936); Ga. Board of Examiners v. Friedman's Jewelers, Inc., 183 Ga. 669, 189 S. E. 238 (1937). See also Sage and Allen Co. v. Wheeler, 119 Conn. 667, 179 Atl. 195 (1935); State v. Gus Blass Co., 193 Ark. 1159, 105 S. W. (2d) 853 (1937).

[91] However, IOWA CODE (1939) §2438.3 expressly classifies optometry as one of the learned professions, placing it in the same category with medicine, surgery and dentistry.

[92] Ollendorf Watch Co. v. Pink, 253 App. Div. 73, 300 N. Y. Supp. 1175 (1937).

practice of guaranteeing to replace purchased tires for defects of whatever character. The Ohio court said:[93]

> We are unable to discern any essential difference in the character and effect of the various forms of agreement of indemnity. . . . Such constitutes an undertaking to indemnify against failure from any cause. . . . It is substantially an unconditional promise of indemnity, and that is insurance.

Restrictions as to Time

The early restrictions on the opening and closing hours of businesses were based on the state's power to regulate nuisances in the interest of the public welfare. Under this power an ordinance of San Francisco prohibiting washing and ironing in public laundries from ten in the evening to six in the morning was upheld by the Supreme Court of the United States[94] in 1885. Later, an ordinance of Butte, Montana, regulating the opening and closing hours of persons engaged in the operation of pawnshops, second-hand stores and junk shops was upheld by the Supreme Court of Montana as a reasonable exercise of the state's police power.[95] Sustainment of a similar ordinance adopted by Louisville, Kentucky, followed.[96] The sale of jewelry by auction was successfully restricted under a New York statute which provided that all sales of goods by public auction in the City of New York must be made in the daytime, "between sunrise and sunset."[97] The opinion that the sale of soft drinks may lead to the sale of drinks "not exactly soft in nature" was given as the reason for enforcing an Oregon law prohibiting the sale of soft drinks between the hours of midnight and five in the morning.[98] Pool parlors and billiard rooms have been subjected to similar restrictions,[99] and in 1908 an Ohio statute providing for the closing of barber shops on Sundays was upheld as a valid regulation of that industry.[100]

For a period of over two decades legislative attempts to regulate the opening and closing hours of barber shops during week days unsuccessfully sought judicial inclusion within the proper exercise of the state's police power. In 1926, the City of Atlanta, Georgia, adopted an ordinance providing that all barber shops in the city should be closed during week days at 7:00 P.M. and on Saturdays at 9:00 P.M. The City of Laramie, Wyoming, adopted a similar ordinance, and ordinances of like character were adopted in cities in Louisiana, Mississippi, California, Washington and Minnesota. All of these regulations were declared invalid as being in violation of the due process clauses of the state and federal constitutions.[101] Many

[93] State v. Western Auto Supply Co., 134 Ohio St. 163, 171, 16 N. E. (2d) 256, 259 (1938).

[94] Barbier v. Connally, 113 U. S. 27 (1885). See also Loon Hing v. Crowley, 113 U. S. 703 (1885).

[95] City of Butte v. Paltrovich, 30 Mont. 18, 75 Pac. 521 (1904).

[96] Hyman v. Boldrick, 153 Ky. 77, 154 S. W. 369 (1913).

[97] Biddles v. Enright, 239 N. Y. 354, 146 N. E. 625 (1925). See also Clein v. Atlanta, 164 Ga. 529, 139 S. E. 46 (1927).

[98] Churchill v. Albany, 65 Ore. 442, 133 Pac. 632 (1913).

[99] Tarkio v. Cook, 120 Mo. 1, 25, S. W. 202 (1893).

[100] Stanfeal v. State, 78 Ohio St. 24, 84 N. E. 419 (1908). For other cases, see Anno. (1928) 55 A. L. R. 242.

[101] Chaires v. City of Atlanta, 164 Ga. 755, 139 S. E. 559 (1927); Newman v. City of Laramie,

strong dissenting opinions, however, argued in favor of the ordinances on the ground of regulating the hours of labor for barbers. To limit the hours of labor that a barber may work each day, it was contended, is within the police power of the state, especially when there is urgent need to protect the "one-man shop against the evils arising from the (three shift) chain and all night barber shops."[102]

In 1927, a bold New Jersey court adopted the minority view to uphold an Atlantic City ordinance requiring barber shops to close at 9:00 P.M. on Saturdays and at 8:00 P.M. on week days. The court felt that[103]

> . . . to allow barber shops to remain open to the public at all hours of the night might well be regarded as rendering ready and adequate inspection inconvenient or difficult or even impossible, and consequently detrimental to public health. Such considerations are for fair determination of the municipal authorities, and we cannot say that the regulation in the instant case is unreasonable.

In commenting on this logic, an Ohio court, upholding a similar ordinance of Zanesville, said:[104]

> We do not regard this reasoning as "specious." . . . Barber shops, which are usually respectable, and operated by law-abiding citizens, may become lounging places for the idle and dissipated, and so a menace to minors, and often in our cities the barber shop in front may be a blind for a den of thieves, professional gamblers, gangsters and racketeers behind.

And, in its zeal to uphold the ordinance, the court continued:

> This situation is well known, and is even a matter of common knowledge among policemen in our large cities. At the time a certain policy racket man and former bootlegging beer baron was recently killed in New York City, two of his henchmen were shot down in a midnight barber shop. . . . If barber shops may run at all times of the night the number of vicious places of this character will inevitably be augmented. . . . We are of the opinion that the provisions of the ordinance under inquiry are neither unreasonable, discriminatory, arbitrary, nor capricious, and that they bear a "real and substantial relation" to the object sought to be attained; namely, public health, morals, and safety.

A similar ordinance enacted by the City of Cincinnati was upheld by the federal district court for the Southern District of Ohio.[105] The most recent enactment is

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40 Wyo. 74, 275 Pac. 106 (1929); City of Alexandria v. Hall, 171 La. 595, 131 So. 722 (1931); Knight v. Johns, 161 Miss. 519, 137 So. 509 (1932); Ganley v. Claeys, 2 Cal. (2d) 266, 40 P. (2d) 817 (1935); Patton v. City of Bellingham, 179 Wash. 566, 38 P. (2d) 364 (1935); Pavlik v. Johannes, 194 Minn. 10, 259 N. W. 537 (1935).

[102] See Patton v. City of Bellingham, *supra* note 101.

[103] Falco v. Atlantic City, 99 N. J. L. 19, 21-23, 122 Atl. 610, 611 (1924).

[104] Wilson v. City of Zanesville, 130 Ohio St. 286, 295-296, 199 N. E. 187, 193-195 (1936). Judge Jones, dissenting, said: ". . . one reading the majority opinion may well wonder what the real crux of this controversy between the city and the barber is. . . . This ordinance may be such that would receive the approval of a Soviet or Fascist regime. . . ."

[105] Feldman v. City of Cincinnati, 20 F. Supp. 531 (S. D. Ohio 1937). *Contra:* Opinion of the Justices, 300 Mass. 615, 14 N. E. (2d) 953 (1938); Oklahoma City v. Johnson, 183 Okla. 430, 82 P. (2d) 1060 (1938).

an Indiana law,[106] as yet uncontested but similar in many respects to other barbering codes upheld in several states.[107] Its gist is that

the Board of Barber Examiners shall have power to approve and, by official order, to establish the days and hours when barber shops may remain open for business, whenever agreements fixing such opening and closing hours have been signed and submitted to the Board by any *organized and representative group of barbers,* and after such agreements have been signed by at least eighty per cent of the barbers licensed by said board and operating in any trade area of the state, and shall have the power to investigate the reasonableness and propriety of the days and hours fixed by such agreements.

Although the numerical weight of judicial authority continues to be against the validity of such restrictions, the trend is in the opposite direction on the ground that reasonable business hours enable municipal officers to fix a definite time within which sanitation inspectors may readily and adequately perform their duties. It is also said that public health and safety are safeguarded by forcing the shops to close at certain hours to prevent fatigue on the part of barbers wielding "keen edged razors and sharp scissors"; and that by keeping respectable business hours "crime and nuisance would be appreciably eliminated."

Thus the restrictions accumulate in the name of sanitation and public health and welfare. And the owner of the one or two chair barber shop is limited further in his competition with the larger and more elaborate shops. The opportunity he has of getting certain patronage in the evenings and on Sundays is eliminated, even though the majority of the inhabitants residing within the immediate vicinity of the shop are employed or otherwise occupied and unable to obtain their hair-cut, shave or manicure within the prescribed hours. Restrictions such as these may provide employment for a great many barber inspectors but they certainly accomplish very little to help the plight of the thousands of small barber shops throughout the country.[108]

Restrictions as to Place

Aside from the many detailed and exacting zoning provisions imposed by states and municipalities on the location of one's business, trade or occupation, numerous other devices have been employed under the guise of police power and revenue raising to prevent not only out-of-state but out-of-town and county businesses from competing with local merchants. It is this type of marketing barrier which, because of the directness of its geographical limitations against "outsiders," most closely resembles the so-called interstate trade barrier. These are the laws enacted by states, municipalities, villages and townships which either on their face or in practical

[106] Ind. Laws 1939, c. 108, §4.

[107] The constitutionality of the master barber codes' hour as well as price regulation is discussed at a later point in this article.

[108] According to the U. S. Bureau of Labor Statistics, in 1935 there were 125,455 barber shops in the United States, their annual receipts for all services rendered during that year amounting to nearly $230,000,000, or approximately an $1800 average for each shop. Out of this the barber, whether operating a large or small shop, had to pay salaries, rent, supplies, miscellaneous expenses, and a return on his investment in establishing himself in business. (1939) 48 MONTHLY LAB. REV. 1287.

effect operate to the disadvantage of persons, products and services coming from other communities and to the advantage of local residents, products and businesses.

Hawkers and peddlers have frequently been restricted in their activities by municipalities. Many of these restrictions have been declared invalid under either the due process, equal protection or interstate commerce clauses.[109] But other courts have held that classifications between residents of a city and non-residents are fully justified where the circumstances and conditions are different. The Supreme Court of South Carolina upheld a Sumter ordinance exacting an annual license fee of $25 from local bakers, while doubling this fee for bakeries with an established place of business out of the city and selling or delivering their product within the city of Sumter. The court said:[110]

> . . . unless there is evidence to show that the imposition of a higher license on non-residents was unreasonable, capricious or confiscatory, no provision of either the constitution of the state or of the United States was violated.

So also, the Florida high court, in placing the I. Miller Shoe Company within the classification of businesses subject to a Florida itinerant merchants tax law,[111] found[112]

> . . . little constitutional difficulty to be encountered in a legislative attempt to single out for special taxation that class of merchants whose business is presumptively so profitable that they can make sufficient profit in three months to pay twelve months' rent, and enjoy a nine months' vacation from business on the profits of the three.

The I. Miller Shoe Company is a nationally advertised company. Its store in Miami had a stock valued at $2,000 plus fixtures and the company held a lease on the premises from year to year.

An ordinance adopted by Lynchburg, Virginia, levies a tax

> On every person, firm or corporation engaged in towel service or the renting or furnishing of towels for compensation, $25 per annum. . . . On every person, firm or corporation (other than a laundry or dry-cleaning establishment located in the City of Lynchburg, paying regular laundry or dry-cleaning taxes in the City of Lynchburg) engaged in soliciting general laundry or dry-cleaning work, including towel or laundry service, or the renting or furnishing of towels and linens for compensation, where said person, firm or corporation does the laundry or dry-cleaning work thereon outside of the city, or has it done outside of the city, $300 per annum, not prorated.

This measure was declared to be a valid exercise of the municipality's taxing power.[113] Emphasizing that "classifications are to be sustained whenever there is

[109] O'Connell v. Kontojohn, 131 Fla. 783, 179 So. 802 (1938), declaring invalid an ordinance imposing a license tax of $250 on each truck wagon operated in Pensacola, Florida, by wholesale bakers located outside the city. See also *Ex parte* Smith, 100 Fla. 1, 128 So. 864 (1930); Ward Baking Co. v. City of Fernandia, 29 F. (2d) 789 (S. D. Fla. 1928); Hair v. Humboldt, 133 Kan. 67, 299 Pac. 268 (1931).

[110] American Bakeries Co. v. City of Sumter, 173 S. C. 94, 174 S. E. 919 (1934), *cert. denied,* 293 U. S. 523 (1934).

[111] Fla. Laws 1929, c. 14528.

[112] Greenleaf & Crosby Co. v. Coleman, 117 Fla. 723, 745-746, 158 So. 421, 429 (1934).

[113] Richmond Linen Supply Co. v. Lynchburg, 160 Va. 644, 169 S. E. 554 (1933), *aff'd,* 291 U. S. 641 (1934). See also Vaugh v. Richmond, 165 Va. 145, 181 S. E. 372 (1935).

any fair basis for them," the Virginia Supreme Court found the discrimination a fair basis for classification on the oft-repeated proposition that local businesses are otherwise locally taxed, directly and indirectly, while the non-resident wholly escapes such taxation. The court argued that if the taxes in question were equalized, the local merchants would have cause for complaint as they are at the same time required to pay property and water taxes which are not levied against their out-of-town competitors. The court concluded that

> Experience has shown that these nation-wide corporations sometimes destroy the business of local competitors, and in many communities are conduits rather than reservoirs of capital. This seems to be the basis of chain store legislation. Its wisdom is not for the courts.

But the court added, rather apologetically:

> Those underlying principles which have brought it [the ordinance] about apply in the instant case. Public policy is with the city.

Classifications such as these, based solely on residence or non-residence, are obviously arbitrary and unreasonable. The state-wide merchant pays taxes in his own community comparable to property, water and other taxes on local merchants. In addition, they are discriminatory and restrictive of competition through their establishment of provincial tariffs for the protection of local monopolies. The trend, however, appears to be toward greater licensing tax differentials levied by municipalities upon non-residents. It is likely to continue if the courts persist in the dilution of the due process and equal protection clauses.[114]

Price Restrictions

Finally to be considered under the relation of persons in business to each other is legislation authorizing price-fixing within different types of distributive occupations. Since the decision of the Supreme Court of the United States validating the New York milk control act,[115] many states have adopted price-fixing statutes affecting a wide variety of products and businesses.[116] That decision, however, has given rise to a considerable amount of confusion as to just how far a state may proceed with price-fixing legislation. The Supreme Court, prior to the *Nebbia* case, had quite generally adhered to the view that price-fixing by the state was valid only when applied to businesses affected with a public interest.[117] But the Court, in the *Nebbia* case, indicated[118] that

[114] Campbell Baking Co. v. Harrisonville, 50 F. (2d) 670 (C. C. A. 8th, 1931); Jewel Tea Co. v. Troy, 80 F. (2d) 366 (C. C. A. 7th, 1935); Williams v. Bowling Green, 254 Ky. 11, 70 S. W. (2d) 967 (1934). See also Notes (1931) 5 So. CAL. L. REV. 164, (1937) 85 U. OF PA. L. REV. 323, (1934) 43 YALE L. J. 1314; Note, *The Legislative Monopolies Achieved by Small Business* (1939) 48 YALE L. J. 847. Municipal power in this and other regards is carefully analyzed in McIntire and Rhyne, *Municipal Legislative Barriers to a Free Market, infra* this issue.

[115] Nebbia v. New York, *supra* note 5.

[116] In addition to special price legislation, 44 states have adopted resale price maintenance acts and 25 states have adopted sales-below-cost legislation. See STATE PRICE CONTROL LEGISLATION (W.P.A. Marketing Laws Survey, 1940).

[117] New State Ice Co. v. Liebmann, *supra* note 6.

[118] Nebbia v. New York, *supra* note 5, at 536.

there is no closed class or category of businesses affected with a public interest, and the function of courts in the application of the Fifth and Fourteenth Amendments is to determine in each case whether circumstances vindicate the challenged regulation as a reasonable exertion of governmental authority or condemn it as arbitrary or discriminatory. . . . But there can be no doubt that upon proper occasion and by appropriate measures the state may regulate a business in any of its aspects, including the prices to be charged for the products or commodities its sells.

As a result of this language, it has been argued that the " 'magic formula' affected with a public interest" has been repudiated and that price-fixing is now placed with other types of restrictions on the use of private property as one which is invalid only if arbitrary in its particular application.[119] On the other hand, there appears no justification for the conclusion that the *Nebbia* case is authority for legislative price-fixing in all commodities. "What the legislative power may be in a given case regarding any industry we do not undertake to say. Sufficient unto the day is the power thereof."[120]

Legislative attempts to exercise price-fixing authority have in any event taken on some interesting aspects. Several states have enacted statutes designed to fix the prices at which a barber may sell his services. Such legislation, in general, authorizes an administrative agency to establish minimum prices for barber work. A usual restriction on the authority of the board requires that it conduct an investigation for the purpose of determining that such established prices are just and reasonable. Ordinarily price levels are submitted by organized groups composed of seventy-five percent of the barbers of a particular governmental unit within the state, such as a county or judicial district. A legislative finding of an economic emergency is usually set forth in the statute.[121]

This type of legislation has received rather severe treatment at the hands of state courts. An examination of the cases reveals varying grounds for the invalidation of such statutes. An Iowa court took the view that the act violated personal liberty in that it restricted the contractual rights of individual barbers.[122] In Florida a similar statute was found unconstitutional as a denial of equal protection and due process and as an improper restraint on freedom of contract.[123] The courts of Tennessee and Alabama were not inclined to look upon the barbering business as one affected with a public interest and, accordingly, invalidated the legislation in each state.[124] Both courts attempted to distinguish the *Nebbia* case by reasoning that the

[119] DOSKOW, HISTORIC OPINIONS OF THE UNITED STATES SUPREME COURT (1935).

[120] Darweger v. Staats, 267 N. Y. 290, 308, 196 N. E. 61, 67 (1935). See also Doubleday, Doran & Co. v. Macy & Co., 269 N. Y. 272, 199 N. E. 409 (1936).

[121] See note 108, *supra*.

[122] Duncan v. City of Des Moines, 222 Iowa 218, 268 N. W. 547 (1936). It should be noted that the decision in this case was based on the authority of Adkins v. Childrens Hospital, 261 U. S. 525 (1922), specifically overruled by West Coast Hotel Co. v. Parrish, 300 U. S. 379 (1937). Furthermore, the statute made no attempt to fix wages of employees.

[123] Fulton v. Ives, 123 Fla. 401, 167 So. 394 (1936); but see Miami Laundry Co. v. Florida Dry Cleaning & Laundry Bd., *infra* note 128, holding valid the Florida laundry and dry cleaning act.

[124] Mobile v. Rouse, 233 Ala. 622, 172 So. 266 (1937); State v. Greeson, Board of Barber Examiners v. Melton, 174 Tenn. 178, 124 S. W. (2d) 253 (1939).

right of a state to regulate barbers is not absolute and must be exercised in a reasonable manner so as not to interfere with private rights.

On the other hand, the Louisiana court, when presented with the question, made much of the economic chaos existing in the milk industry in the New York milk shed area. A similar situation is said to have existed in the barber trades in many states prior to the adoption of these statutes,[125] thus affording factual basis for the legislative findings to this effect. With this background the Louisiana court, after having first declared the barbering statute of that state unconstitutional, reversed itself on rehearing and permitted the statute to stand. The opinion followed the *Nebbia* decision, finding the act a legitimate exercise of the police power and not unreasonable or arbitrary. There was included in the law a legislative determination that low prices made it impossible to support and maintain reasonably safe and healthful barbering services to the public.[126] The result was declared by the legislature to be a menace to the health, welfare and reasonable comfort of citizens of the state and one which tended toward the transmission of disease. In addition, the legislature had declared an acute economic condition to exist, resulting in great disparity between the prices of barber work and other commodities. This condition was found to be largely instrumental in destroying the purchasing power of barbers in industrial and sanitary products essential to the operation of business, thus impairing and injuring the public health and safety.

But barbering is by no means the only business which has been subjected to price-fixing legislation of this type. Consider, for instance, a Florida statute setting up a price-fixing arrangement for dry-cleaning and laundry businesses.[127] Here, again, there was a legislative finding of evils prevalent in the industry. The Florida Supreme Court, although it had declared invalid the price-fixing provisions of the Barbering Code, sustained this legislation,[128] arguing that the liberty of contract and the right to use property must be determined in the light of prevailing social and economic conditions. The view taken was that when conditions in a business become such that the welfare of the public will not be adequately protected by unrestricted competition, it is within the police power of the state to remedy the evil. The court indicated that if it can be shown that ruinous or chaotic conditions are extant within an industry, or that the economic existence of large numbers of people is being threatened, then the legislature may step in and prescribe regulations to correct the alleged or threatened abuses. An interesting and, perhaps, plausible contention was advanced by the minority to the effect that if the state can fix prices for the cleaning and laundry industry, it may do the same for clothing stores, tailors, drug-stores, grocery stores, *etc.*

[125] Compare note 108, *supra*.

[126] Bd. of Barber Examiners of Louisiana v. Parker, 190 La. 214, 182 So. 485 (1938); *cf.* State v. Chisesi, *supra* note 47, holding the farm produce act invalid, even though it made no provision for price fixing of farm products.

[127] Fla. Laws 1937, c. 17894.

[128] Miami Laundry Co. v. Florida Dry Cleaning and Laundry Board, 134 Fla. 1, 183 So. 759 (1938). Compare the language in Fulton v. Ives, *supra* note 123.

Unquestionably, legislative price-fixing has yet to prove its efficacy in curing economic ills. It is worthy of note that in the *Parker* case[129] both sides agreed to a stipulation to the effect that, owing to the economic status of his clientele, the defendant could not earn a livelihood by charging the prices fixed by the board but could do so by charging lower prices. Inspectors had found that the defendant had satisfactorily complied with all sanitary requirements, and this at a time when he was charging less than the minimum price fixed. Anyone acquainted with the processes of milk distribution knows that the industry has in the past operated on an unsound economic basis. Milk control legislation was designed to correct this evil and the United States Supreme Court recognized it as such. It has not been demonstrated, however, that legislative price-fixing in the milk, any more than in any other, industry is a satisfactory solution to the problems of either the producer or the consumer. In the City of Washington, D. C., there is no price-fixing in the milk industry. Competition in the sale of milk is relatively free and unfettered. Virginia, on the other hand, has a Milk Commission with power to fix prices. An editorial from the *Washington Post* for March 4, 1941, reprinted in the footnote,[130] illustrates at least some of the problems involved under legislative determination of retail prices.

Reference has been made earlier to the existence of a relatively new type of licensing legislation apparently designed, in a degree at least, to cloak with legislative sanction privately-created price controls in the automobile-selling field. To appraise this development a bit of background is essential. The automobile dealer occupies a rather unique position among retail merchants in that his business is virtually under complete control of the manufacturer. This situation is attributable to the superior bargaining position of the manufacturer which enables the latter to impose extremely difficult terms on the dealer under the threat of withdrawal of "franchise." Exclusive dealing arrangements are integral parts of manufacturer-dealer contracts in the handling of both vehicles and parts, accessories and supplies. Further restrictions on the dealer include territorial limits placed on sales, manufacturer-supervised accounting systems, display rooms, advertising, and "forced sales." The existence of such practices is a severe strain on the operation of the competitive

[129] Bd. of Barber Examiners of Louisiana v. Parker, *supra* note 126.

[130] "MILK PRICES

"Retail milk price fixing is a hangover from the days of NRA, when any measure was seized on to preserve the shaky status quo. But methods of distributing milk have brought such economies that the price structure has been naturally undermined. Already Washington is experiencing the benefits of such simple innovations as the paper container, which makes price reduction sound by eliminating the loss of bottles, and the two-quart sale, which accomplishes the same result by reducing overhead. A fixed retail price, however, effectively prevents such innovations, because the consumer, if he must pay the same price, demands his milk in glass bottles a quart at a time.

"It is true in milk as in everything else that a lower price would bring more trade if the enterprising distributor could reduce his prices through his economies. But under the present system, experimentation is penalized. Hence the old methods, and the old prices, remain. If the Virginia Milk Commission can find any good way to apply efficient methods to the maximum benefit of the consumer's pocketbook without abandoning its price-fixing policy, all right. If the commission can't, then it looks very much as if the policy is a barrier to progress."

principle and two agencies of the Federal Government have intervened in an effort to relieve hardships upon dealers as well as upon the automobile consumer.[131]

Activities of dealers themselves, however, have not been entirely irreproachable. An investigation by the Federal Trade Commission[132] reveals that dealers in many cities and states have, without legislative sanction, engaged through associations in the promotion of plans which appear to have as their main object the restriction of price competition among their members. These plans have been developed largely for the purpose of combating the deleterious effects on the automobile market of the ever-increasing number of used cars. In actual operation, they appear in a rather sinister garb, involving secret code numbers given deals, secret telephone numbers given appraisal bureaus and penalties levied on dealers failing to comply with rules and regulations of the organization.

Examination of the new dealer licensing statutes reveals clearly a purpose to give legislative sanctity to such regulations of the industry, particularly in the matter of price control. Interesting questions may be raised with respect to the legality of parts of these statutes.[133] Compare, for instance, Section 60-913 of the Nebraska statute with Section 1315 of the Pennsylvania statute,[134] declared unconstitutional in its earliest days.

The following provision is from the Nebraska act:

For the purpose of determining whether or not an applicant for a license or a holder of a license has violated any of the provisions of this law with particular regard to price discrimination and excess allowances on used motor vehicles, the administrator may authorize . . . a survey to be made to determine a fair basis for allowances to be made for used cars in purchases thereof or exchanges for other new or used cars. Such survey, if made, shall be amended from time to time as market conditions change. . . . Said survey shall serve as a guide and shall in no way be binding upon any licensed dealer or salesman except for the purpose stated hereinbefore in this Act.

The Pennsylvania act provided that:

The Commission shall, within thirty (30) days from the time it is established, determine by a survey what the average sale price for used motor vehicles was for each make, model, body type and year, and shall issue orders that for the ensuing thirty (30) days no appraiser shall appraise a used motor vehicle for a greater amount.

The provision of the Pennsylvania statute was invalidated[135] on the ground that the automobile business was not one affected with a public interest to such an

[131] *In the Matter of General Motors Corporation and General Motors Sales Corporation*, F. T. C. Docket No. 3152. The Antitrust Division of the U. S. Dep't of Justice has been successful in securing indictments under the Sherman Act against General Motors and certain affiliated corporations, the Ford Motor Company, the Chrysler Corporation and finance companies controlled by them. Consent decrees were entered against Ford and Chrysler who had only working agreements with finance companies. General Motors, electing to stand trial, was found guilty. U. S. v. General Motors Corp., 26 F. Supp. 353 (N. D. Ind. 1939).

For a discussion of the consent decrees, see Birnbaum, *The Auto Finance Consent Decree: A New Technique in Enforcing the Sherman Act* (1939) 24 WASH. U. L. Q. 525. For a discussion of the relationship between automobile manufacturers and their agents, see Comment, *The Antitrust Laws and the Automobile Industry* (1940) 34 ILL. L. REV. 956.

[132] Note 2, *supra*. [133] See note 33, *supra*. [134] The statutes are cited *ibid.*

[135] Heinel Motors, Inc. v. Teefy, *supra* note 33.

extent as to justify the periodic fixing of maximum prices. The Nebraska statute, on the other hand, does not attempt to establish maximum prices as such. Instead, the "fair basis of allowance" is made a criterion or guide by which the administrator may determine whether or not a dealer is engaging in price discrimination or giving excess allowances on used cars. He then determines on the basis of the survey whether a dealer's license should be denied or revoked. This approach has a less coercive aspect, but it appears to reach substantially the same result as the Pennsylvania Act. The Nebraska statute has not, however, been challenged on the basis of constitutionality.

CONCLUSION

No attempt has been made herein to explore exhaustively the countless number of restrictions which operate to harass the life of the small business man, regardless of his calling. But it is believed that a sufficient number of illustrations has been given to emphasize the effect on business enterprise of this series of progressive restrictions in the form of legislative restraints. Many of these restrictions cannot be justified in the name of protection of the public health, safety and welfare because they are regulatory far beyond any such requirements. Unquestionably many such statutes have been inspired and placed on the books by the activity of pressure groups with selfish motives. Many have also been prompted by a sincere desire to solve the problem of what to do with small business.

Let no one mistakenly believe that these legislative limitations have only local implications. They have a cumulative effect on our national economy as a whole. When the business activity of "the butcher, the baker, the candle-stick maker" is obstructed by unwarranted statutory obstacles, the purchasing power of the nation is vitally reduced. Whatever case may be made out for governmental supervision of large industrial units, it has little application to the situation presented here. Many of the statutes discussed are capable of being used, and many are actually being used, for the strangulation of the individual initiative of persons in lower economic levels.

NOTE ON GOVERNMENTAL PRODUCT FAVORITISM

The Editor regrets keenly that unexpected difficulties prevent publication of a completed analysis by an able commentator of state and federal legislation effecting, and the economic implications of, governmental favoritism between products.[1] For just as elementary economic theory distinguishes between commodity and substituted competition, so governmental restrictions on entry of products into the market comprise not alone qualitative and quantitative limitations on given products[2] but, as well, marketing handicaps that advantage one product at the expense of a competing commodity.[3] Such product favoritism ranges from the intended to the indirect to the unintentional, the legislative measure inducing it may in its immediate incidence restrict the one commodity or promote the other; but in any case government plays the favorite and varying economic impact follows in its train.

Because the production of particular products, like the shaping of human character, is so largely conditioned by environmental factors, product favoritism is often

[1] Instances of product favoritism on the local level are collected in McIntire and Rhyne, *Municipal Legislative Barriers to a Free Market, infra* this issue; effectuation of favoritism between competitive products by administrative action is considered by Bane, *Administrative Marketing Barriers, infra* this issue.

[2] Silverman, Bennett and Lechliter, *Control by Licensing Over Entry Into the Market, supra* this issue, discuss some of the types of product restriction which adversely affect commodity competition. Tucked away in the statute books of the American states are other types of such limitation. It is common in liquor control legislation to find quantitative restrictions on the amount of intoxicants that can be sold to any one person at one time. W. VA. CODE (1937) §5907 (49) is illustrative. Quantitative limitation may also be legislatively decreed at the production stage. N. Y. AGRIC. & MARKETS LAW §258j prohibits municipal authorities from approving any new milk dairy or plant or authorizing the shipment of milk "from such premises or plant for sale or use within this state without satisfying the commissioner that such proposed added milk supply is *reasonably needed* for such municipality . . ." (ital. added). OKLA. STAT. ANN. (1937) tit. 52, §272 phrases the measurement of limitation expressly in terms of the self-interest of the industry involved: "The taking of crude oil or petroleum from any oil bearing sand or sands . . . at a time when there is not a market demand therefor at the well at a price equivalent to the actual value of such crude oil or petroleum is hereby prohibited. . . ." Restrictions on the use of natural resources are sometimes of a qualitative rather than a wholly quantitative character. Thus DEL. CODE (1935) §3008, and N. J. REV. STAT. (1937) §23:5-25 prohibit the conversion of food fish into oil or fertilizer; their use for other purposes is not limited. Legislation of like tenor is to be found in state enactments directed at the control of human resources. OHIO GEN. CODE (Throckmorton, 1940) §2228-1, prohibiting open-market sale of convict-made goods, and *id.* §§12993 *et seq.*, forbidding labor of children under sixteen years of age, are typical of limitations on commodity competition imposed by reason of the particular labor group involved in their production.

[3] Silverman, Bennett and Lechliter, *supra* note 2, in the course of their discussion also cite instances of those governmental restrictions which effect favoritism in product competition. The importance of this form of barrier merits, however, separate, extended treatment.

an expression of geographical interests. There is, in short, a close interrelationship between the type of barrier here under consideration and the more familiar interstate trade barrier. Butter's antipathy for margarine, translated through a powerful lobby into widespread legislation restrictive of the latter's manufacture and sale, is the outstanding illustration of this hybridism.[4] Numbered in the thirties are the states which, following the celebrated federal excise of ten cents per pound,[5] heavily tax or otherwise prohibit the sale of colored margarine.[6] At least nine states have five to fifteen cent excises on uncolored margarine as well,[7] a complete protection which in recent years the dairy interests have wished from the federal government because of the significant rise, in the face of the lesser prohibition, in the percentage of margarine to butter consumption.[8]

When, some twenty-odd years ago, vegetable oils began to supplement animal fats as the basic margarine constituent, feuds commenced within the margarine family itself. Three of the important cattle-producing states lay an excise on all margarine not containing a substantial percentage of animal fats.[9] Search has revealed no Southern state counterpart favoring the vegetable oil base, probably because Southern agriculture has an interest in cattle and hogs as well as in cottonseed. Southern states have, however, joined in the trend toward elimination of the foreign coconut oil in aid of products locally produced.[10] Thus Tennessee has just amended its ten-year-old "all-out" law to exempt from that ten cent excise on all colored and uncolored margarine, brands containing no oil ingredient save peanut, soybean, cottonseed or corn and no fat ingredient other than beef, milk and neutral hog lard.[11] The domestic-oil coverage provided in this exemption, although quite common, is here and there expanded or contracted to effect favoritism as well between continental American sources of vegetable oils.[12] Butter loses legislative ground as

[4] Thus see the treatment of the margarine laws in Truitt, *Interstate Trade Barriers in the United States*, *supra* this issue.

[5] 53 STAT. 247-248, 26 U. S. C. A. §§2300-2301 (1939).

[6] Taylor, Burtis and Waugh, *Barriers to Internal Trade in Farm Products* (U. S. Dep't Agric., 1939) 19; *Barriers to Trade Between States* (Marketing Laws Survey, 1939) 31-45.

[7] *Ibid.*; see also Truitt, *supra* note 4, at 213.

[8] Buell, *Death by Tariff* (Aug. 1938) 18 FORTUNE 32, 34. Aside from legislation of the type described, use is made of onerous labelling requirements, prohibitions on sales to state institutions, etc., and heavy license fees required of manufacturers, dealers, dispensers and even consumers, in order to aid butter. Provisions of these types are collected in *Barriers to Trade Between States*, *supra* note 6.

[9] Taylor, Burtis and Waugh, *supra* note 6, at 20; Truitt, *supra* note 4, at 213.

[10] See Truitt, *supra* note 4, at 213, citing from testimony before the T.N.E.C. The Federal Congress also joined in this protectionist move both by limiting the amount of duty-free importations of coconut oil and by imposing an excise of 3-5 cents on the first domestic processing of coconut and palm oils in case an effort was made to import the oil-producing products. 53 STAT. 264, 26 U. S. C. A. §2470 (1939).

[11] Tenn. Laws 1941, c. 71, amending Tenn. Laws 1931, c. 19.

[12] As ordinarily worded, the exemption imports a discrimination against pecan oil which Georgia overcomes by expanding the favored group to include this type of oil. Colorado, Kansas and Minnesota, failing to extend exemption to soybean oil, discriminate against a product not of the South but of sister states in the midwest section. *Barriers to Trade Between States*, *supra* note 6, at 33, 34, 35, 37.

The Minnesota law, 3 MINN. STAT. (Mason, 1940 Supp.) §3855-10, is unique in effecting a combination form of exemption by taxing oleomargarine containing (1) less than 65% animal fats and/or oils or (2) any fats and/or oils other than animal, milk, peanut, cottonseed, or corn. This explains the reference to Minnesota in both the present note and note 9, *supra*.

the demand for governmental protection of home products, taking its cue from the pioneer dairy lobbyists, spreads to embrace other economic interests.

One area affected in this extension of protectionist philosophy has been the related one of cooking oils and shortenings. South Dakota in 1931 laid an excise of five cents per pound on vegetable oils and vegetable cooking compounds except those made of corn oil.[13] Admittedly enacted to protect the home hog industry, it was followed by what have been described as "repeated attempts . . . in Middle-western States to pass laws designed to protect lard and corn oil against out-of-State substitutes, particularly cottonseed oil."[14] The Iowa legislature in 1934 and again in 1937 considered legislation to tax lard substitutes. The later bill, calling for a prohibitive tax of $5 per pound on all shortening other than lard, precipitated a resolution in the Georgia legislature expressing that body's "regret" at the proposed action of the sister commonwealth.[15] Recent intense competition with corn oil, lard and soybean oil is seriously threatening outlets for cottonseed oil, which has of late represented close to ten percent of the value of the Southern cotton crop.

Limitation of cotton acreage under the Federal Agricultural Adjustment Acts of 1933[16] and 1938[17] has at the same time meant a corresponding decline for the South in its cottonseed oil production. The consequent loss in the oil market has been taken up largely by expansion in soybean production, which is confined for the most part to the East Central States.[18] Removal of the surplus peanut crop from the edible trade through diversion to the oil market, effected by what is now the Surplus Marketing Administration, has enabled Southern farmers to make up a part of their loss in this market occasioned by the enforced reduction in cottonseed oil. But peanut oil averages less than one percent of the total of fats and oils produced; nor is it profitable to sell peanuts for oil at prevailing prices.[19] Of similarly less direct but albeit cognizable geographical favoritism are numerous provisions to be found among the exemption statutes of state property taxation. Thus Wyoming grants a five-year exemption to property used in the manufacture of beet sugar or beet sugar products.[20] Some exemption provisions are so inclusive, however, that their purpose is more to stimulate a general economic development rather than to foster one product over another. This appears to be true of Mississippi,[21] which

[13] S. D. Laws 1931, c. 259, repealed by S. D. Laws 1933, c. 183.

[14] Taylor, Burtis and Waugh, *supra* note 6, at 30. See *Wesson* (Sept. 1939) 20 FORTUNE 67, for a discussion of the South's problem viewed through the corporate eyes of the manufacturers of Snowdrift and Wesson Oil.

[15] Ga. Laws 1937, pp. 2190-2191. Neither Iowa bill was enacted. Compare the joint resolution adopted by the Wisconsin legislature in an effort to placate the cotton states over Wisconsin's hostility toward margarine. See Truitt, *supra* note 4, at 217, n. 39.

[16] 48 STAT. 31 (1933).

[17] 52 STAT. 31, 7 U. S. C. A. §§1281-1407 (1938).

[18] See SEN. REP. No. 147, 77th Cong., 1st Sess. (1941) at 2.

[19] *Ibid.*

[20] WYO. REV. STAT. (Supp. 1939) ¶115.105 A. Present possibilities in the competition of sugar with corn derivatives are indicated in *Corn Products* (Sept. 1938) 18 FORTUNE 55.

[21] MISS. CODE ANN. (Supp. 1938) c. 61, ¶323. *Cf.*, however, *id.* ¶317G exempting lint cotton for five years and cottonseed for one.

has been a leader among Southern states in efforts to lure industry across the Mason and Dixon line.[22]

State and federal expenditures for highway construction afford a classic illustration of geographical favoritism in product competition effected indirectly—and doubtless unintentionally—through an economic chain of causation. Good roads are responsible for the competitive advantage which motor carriers now enjoy in some respects over rail transportation. Emergence of the motor truck as a significant means of carriage has, in turn, been enormously advantageous to the seafood industry. Oysters, especially, are now placed in Midwestern towns in active competition with inland substitutes.[23]

With other instances of product favoritism, on the other hand, the geographical factor either has receded into the background or is completely absent. Georgia now exempts from its unit taxes on merchandise vending machines, machines dispensing nuts grown within the United States; North Carolina, machines "that vend solely peanuts and candies made of peanuts containing fifty percent or more peanuts."[24] Georgia, though it has a definite economic interest in the pecan trade, extends the exemption to all other members of the nut family. The Tar Heel state is one of the great peanut-producing areas; yet of the products with which it can be said the lowly peanut "competes" in the edible trade, as many are native as are foreign. Similarly, two states taxing soft drinks exempt from the provisions of their statutes pure fruit and vegetable juices.[25] By imposing on distributors of fuel oil an excise tax not balanced by any comparable exaction applicable to distributors of coal, wood and other competing fuels,[26] the State of Washington plumped for a form of product favoritism which as to it must have been motivated by functional rather than geographical considerations. It has been said that John L. Lewis recently proposed a federal tax of similar purport as one possible cure for the sickness in the bituminous coal industry which competition of other fuels helped to produce.[27] The same authority declares that recent legislation proposed for federal control of the petroleum industry would, if enacted, have empowered the Department of the Interior to prohibit the use of crude oil for fuel.[28]

Not only have fuel oil's competitors been accorded legislative succor; at the other

[22] See Note (1940) 9 DUKE BAR ASS'N J. 15.

[23] See the testimony of John V. Lawrence, *T.N.E.C. Hearings*, 76th Cong., 2d Sess. (1941) Pt. 29, at 16033.

[24] Ga. H. B. 505, 1941; N. C. CODE (Michie, 1939) §7880(61).

[25] S. C. Acts 1939, act 346, §96; W. Va. Laws 1939, c. 119, §30. In extending the exemption only to wholesale and retail groceries selling the juices the West Virginia law at the same time effects a discrimination in methods and channels of distribution. This phase of the barrier question is analysed in Cook, *Legislative Restrictions on Marketing Integration;* Gould, *Legislative Intervention in the Conflict Between Orthodox and Direct-Selling Distribution Channels,* both *infra* this issue.

[26] Wash. Laws 1939, c. 186. The legislation, dating back to Wash. Laws 1935, c. 180, ¶78, was condemned as violative of the equal protection guaranty in State of Washington v. Inland Empire Refineries, 3 Wash. (2d) 651, 101 P. (2d) 975, *cert. denied,* 61 Sup. Ct. 395 (1940).

[27] PETTENGILL, SMOKE SCREEN (1940) 113.

[28] *Ibid.* On the effectuation of barriers through the intended or usurped exercise of administrative powers of discretion, see Bane, *supra* note 1.

end of the petroleum scale gasoline faces some actual, and the threat of much more, legislative partiality for power alcohol. In the initial phases of the competitive struggle, however, legislation may actually operate indirectly to favor the petroleum industry.[29] This is well illustrated by a 1935 development in South Dakota. That state has long required inspection of petroleum products, and prohibited sale as gasoline of any product found to fail the statutory specifications. In the year mentioned the state law was amended in order "that gasoline sold in this state . . . may be blended with completely denatured Ethyl alcohol. . . ."[30] But 1935 saw more than legislative equality attained for the new use of agricultural commodities; Nebraska that same year embarked on a policy it still pursues of suckling the infant competitive product through a technique of tax favoritism. The original enactment effected preferential taxation of blended motor fuels by excluding the alcohol content of alcohol-gasoline mixtures from the definition of taxable motor fuel.[31] A 1939 supplemental enactment exempted the entire mixture from tax when used for other than highway or aircraft purposes, except for that portion of the tax diverted to social security.[32] Administrative complexity and confusion growing out of simultaneous enforcement of these two laws possibly grounds a proposal now before Nebraska's unicameral legislature to exempt all alcohol-blend gasoline from the present five cent motor fuel tax, imposing upon it instead a differential tax of three cents.[33]

Agitation commenced in recent years and extending down into the present months has for its purpose the extension of this brand of governmental product favoritism to other states and to the Federal Congress. These proposals, reaching bill stage to receive legislative consideration, are significant straws in the wind despite their failure of enactment. For not only is their number far from small; nearly every one would build a barrier wall higher than that so far constructed by the Cornhusker state.[34] Some have called for complete exemption;[35] by far the greater number of state proposals and half the federal bills would adopt the European pattern[36] of compulsory blending.[37] It seems reasonable to believe that some at

[29] Compare the Seattle ordinance, which purposely discriminated in favor of liquid fuel dealers, cited in McIntire and Rhyne, *Municipal Legislative Barriers to a Free Market*, *infra* this issue.

[30] S. D. Laws 1935, c. 169, p. 270, now S. D. CODE ANN. (1939) §22.1506.

[31] Neb. Laws 1935, c. 161, now NEB. COMP. STAT. (Supp. 1939) §66-401.

[32] Neb. Laws 1939, c. 82, now NEB. COMP. STAT. (Supp. 1939) §66-431. Since at present 20 percent of the revenue from the regular five cents per gallon motor fuel tax is so diverted, in effect a one cent per gallon tax is levied on blended gasoline when used for the purposes specified, as against the five cent tax required of petroleum gasoline. *Id.* §66-405 levies the tax for social security.

[33] Neb. L. B. 88, 1941. (Feb. 1941) 1 (No. 4) STATE TAX REV. 3.

[34] Neb. L. B. 1, 1939, would have required compulsory blending whenever there existed a sufficient supply of ethyl alcohol. Amer. Petroleum Industries Comm., *Summary of Alcohol-Gasoline Legislation* (1941).

[35] Rep. Harrington, 75th Cong. (complete exemption); Sen. Gurney, 76th Cong. (semble); S. B. 552, 76th Cong. (semble); H. R. 2559, 76th Cong. (semble); *cf.* Idaho H. B. 218, 1941 (exemption of alcohol content only). Data from Amer. Petroleum Industries Comm., *supra* note 34.

[36] See Legis. (1937) 22 IOWA L. REV. 736, 750.

[37] Iowa H. F. 96, S. F. 364, 1939 (police power); Mich. H. B. 294, S. B. 275, 1939 (semble); Minn. H. B. 1430, S. B. 1305, 1939 (semble); Wash. H. B. 567, 1939 (semble); Wash. H. B. 412, 1941 (semble; highway use only); Rep. Knutson, 75th Cong. (prohibitory tax); H. R. 175, 76th Cong.

least of these schemes would have flowered into law were it not for the fact the National Farm Chemurgic Council and interests allied with it have elected to press the farm chemurgy movement wholly in terms of the inherent economic power of the new products to compete successfully in the market place.

This attitude must necessarily account to some extent also for the relative absence of governmental effort to foster other phases of this movement, which, roughly speaking, pits agricultural commodities against those that are the product of the extractive industries and of established industrial processes.[38] The phenomenal rise of the soybean has, so far as search reveals, enlisted only an instance of administrative favoritism.[39] Nor does there appear to be—one would scarcely expect it—any evidence of legislative intervention to protect accepted drug sources from the likely competition of farm wastes only quite recently translated by the chemist's modern alchemy into substances having significant medicinal properties. But while there is to date little actual governmental favoritism in this immediate sense, legislation promotive of the farm chemurgy movement as a whole, and thus indirectly of product favoritism, is not uncommon. The Agricultural Adjustment Act of 1938[40] established four great regional laboratories for extensive research into new uses and new and extended markets for farm commodities and their by-products. Through their agricultural colleges and stations, several states are investing large sums toward the same end.[41]

Federal limitations, through the two Agricultural Adjustment Acts,[42] of the production of basic farm commodities has effected direct favoritism in commodity competition only as a by-product. Limitation of cotton acreage, stimulating a significant expansion in peanut production, would presumably have advantaged the lowly goober beyond the slight gain realized through diversion to the oil market had the edible-trade demand kept pace with that expansion. Failing to do so,[43] there resulted a mounting surplus of peanuts which has now induced legislation extending the marketing quota system to this commodity.[44] That the federal agri-

(police power and prohibitory taxation); H. R. 9582, 76th Cong. (police power over interstate commerce); H. R. 35, 77th Cong. (semble); H. R. 2819, 77th Cong. (police power and prohibitory taxation). Data from Amer. Petroleum Industries Comm., *supra* note 34.

[38] Although the product competition engendered by farm chemurgy in broad outline is one on the functional level, nevertheless legislative succor at times shows definite traces of geographical protectionism. Thus of the nine state bills listed in notes 35 and 37, *supra*, six stipulated for ethyl alcohol produced from agricultural commodities grown within the state. The present Nebraska proposal, cited *supra* note 33, although adhering to existing legislation in specifying that the farm products may be grown anywhere in the United States, excepts black-strap molasses. Regional interests are also reflected in the latest Washington State proposal, *supra* note 37, which specifies that the ethyl alcohol may come from waste or surpluses in farm crops, coal mines, timber, etc.

[39] See Bane, *supra* note 1. This administrative ruling concerned the use of soybean oil in paint; soybean plastics have apparently not provoked legislative retaliation on the part of the products being displaced.

[40] 52 STAT. 31, 37, 7 U. S. C. A. §1292 (1938).

[41] A further promotive device is to be found in North Carolina's limited tax exemption of agricultural products, just enacted. N. C. S. B. 106, 1941. Gould, *supra* note 25, at 322, finds in legislation directed against peddlers and transient merchants, numerous instances of exemptions favoring such products.

[42] Notes 16 and 17, *supra*.

[43] SEN. REP. No. 147, *supra* note 18, at 3.

[44] Pub. L. No. 27, 77th Cong., 1st Sess. (1941).

cultural program has, however, unintentionally produced direct favoritism between products is attested by the experience of the cotton industry under the first agricultural adjustment act. Unintended favoritism arose there as a consequence of the enforcement of the tax imposed upon the first domestic processing of raw cotton, the revenue from which was to be used to pay benefits to the cotton farmer.

"The effect of this tax was to increase in varying amounts the price of all cotton products subject thereto and those cotton products which were in competition with non-cotton products were placed at a serious competitive disadvantage. Such disadvantage was particularly marked in competition between the cotton product and paper bags and other paper containers, some rayon products, paper towels, non-cotton cord and other binding material, paper tapes of various kinds, paper shades and paper napkins and table covers.

"The Act itself contained provisions which were designed to afford relief by providing for a compensating tax on the competing non-cotton product where it could be proved that the tax was causing or would cause a shift away from the use of the cotton product. It was found by experience, however, that while a measure of relief was gained in a few instances, the administrative difficulties and the problems of proving to the satisfaction of the administrative agency that such shifts were taking place, effectually barred any real relief in most cases.

"Moreover, where a compensating tax was imposed on the competing non-cotton product it was frequently found that such product was in turn placed at a competitive disadvantage as against another non-cotton product, although the second product did not compete directly with the cotton product. With regard to protection of domestic cotton products against increased competition from imported cotton products, the situation was somewhat more satisfactory; there an additional tax was placed on the import of the foreign products approximately equal to the tax burden which the domestic products were bearing.

"After the tax was removed following the decision of the Supreme Court of the United States as to its unconstitutionality, many of the markets lost to cotton products as a result of the tax have probably not been wholly regained; the public during the interim having become used to the competitive product. This last, however, is a matter which is almost impossible to measure in mathematical terms and therefore cannot be stated categorically, although it is the confirmed opinion of most of the manufacturers of the cotton products involved.

"The experience of the Industry under the tax has been such as to compel the conclusion that no one product of an agricultural commodity can be singled out to bear the burden of a tax without necessarily placing it at a competitive disadvantage, directly and indirectly, with a large number of non-taxed products and setting up a chain of causation which tends to dislocate the operation of the normal competitive system."[45]

Adequate appraisal of the economic implications of governmental favoritism in

[45] Statement from the Cotton-Textile Institute, March 19, 1941.

product competition requires extended examination at the hands of skilful analysts of economic phenomena. Only a few generalized observations can be here made. Clearly governmental marketing barriers of this type are not to be categorically condemned; product favoritism of each variety must be separately brought before the bar of economic judgment to be examined in terms of its character and its impact upon the public weal. Geographical favoritism, grounded as it is in provincial self-interest, may be more vicious than functional discrimination;[46] functional favoritism, in turn, may be good, bad or neither depending on its direct or collateral impact and on whether it is in aid of new or established product interests. Anti-margarine legislation, preventing or discouraging as it does the consumption by lower income groups of a low-cost,[47] yet equally nutritious[48] butter substitute, cannot be justified on the ground of the importance of the dairy industry. Especially must this be the judgment when it is not at all clear that that industry stands to gain materially from this barrier action.[49] If any discrimination of the old against the new can be justified on such an argument, sick bituminous coal would stand to claim the legislative crutch. Yet even so, actual and proposed legislation looking to this curative for black diamond's economic aches stands suspect on counts analogous to those recited in the indictment of governmental favoritism toward butter. Legislative obstructionism directed at other new competitive products may similarly result in the freezing of prices at arbitrary levels. Such is possibly the case with municipal efforts to prevent introduction of the paper milk container, which offers economies in the cost of milk distribution.[50] Or, although not depriving the consumer of an effective, less expensive substitute, such governmental action may deny him the advantages of an improved article at little or no increase in cost. That this is the situation in the building field is the verdict to be found from evidence and opinion laid before the Temporary National Economic Committee.[51] Like margarine, the articles are more accurately classed as necessities than as luxuries; and the private subsidies in aid of vested interests, governmentally exacted under guise of a public interest, fall heaviest on the lower income groups.

When government puts the shoe of favoritism on the other foot, economic analysis must carefully weigh the consumer's stake in the new style. If any merit remains in the "infant industry" argument, public interest would not appear to be the loser in governmental encouragement of research in farm chemurgy, or in the

[46] On geographical favoritism, whether of persons or products, contrast the attitude of Truitt, *supra* note 4, and Silverman, Bennett and Lechliter, *supra* note 2, with that expressed by McIntire and Rhyne, *supra* note 1.

[47] PABST, BUTTER AND OLEOMARGARINE (1937) c. 3 contains data on the relative prices of butter and margarine; see *id.* at 84 for comment on the significance of low prices for margarine.

[48] See the excellent discussion in SNODGRASS, MARGARINE AS A BUTTER SUBSTITUTE (1930) c. 14. The butter industry's thesis that margarine must be discouraged because detrimental to the public as compared with butter is belied by data on violations of pure food laws. See Truitt, *supra* note 4, at 216, n. 35.

[49] See comment of Taylor, Burtis and Waugh, *supra* note 6, at 27-28.

[50] See Silverman, Bennett and Lechliter, *supra* note 2, at 261, n. 130, quoting from a recent editorial in the Washington Post.

[51] *Id.* at 246, quoting from the T. N. E. C. Hearings.

rephrasing of such definitional requirements as North Dakota's specifications for motor fuel to legalize the use of products unknown at the time of original draftsmanship. Indeed, agriculture's handicap as against industry in the present economy, now fashionably expressed in terms of contrasting rigid and flexible price structures, may well justify differential taxation of those farm commodities that seek to compete in common markets with industrial products. But forced consumption of the new product, despite advanced prices necessitated by higher costs of production possibly accompanied by inferior quality, is a horse of another color. With the economic picture of power alcohol abounding in such consumer shadows,[52] only the strongest emphasis on the urgency of conserving remaining petroleum resources against the rainy days that seem to lie ahead can square such governmental favoritism with public interest. For an economy that remains dedicated to the idea of a free competitive market, governmental playing of favorites among competing products, like public creation of other forms of marketing barrier, is a game which the common weal can indulge in but seldom if it is not to suffer the economic and social consequences so quickly condemned when private interests load the dice without benefit of police protection.

[52] Summary data on the cost and quality of alcohol-blend gasoline may be found in Legis. (1937) 22 IOWA L. REV. 736, 747-749.

LEGISLATIVE RESTRICTIONS ON MARKETING INTEGRATION

Edith N. Cook*

The struggle of one type of business concern to protect itself against competitive encroachments either from new forms of business, or merely from additions to its ranks of more of the same type of competitors,[1] is probably as old as man himself. For where self-interest resides, there one finds resourcefulness in the fashioning of protective weapons. And for each weapon that is removed, judicially or otherwise, from the hands of its fashioners, new ones spring forth from the fertile minds behind those hands. Even as early man devised tangible weapons to wield against encroaching competitors in the form of human or animal enemies who threatened his food supply, so the modern man eternally attempts to devise intangible weapons to wield against threats to his established form of livelihood.

The man in the business of marketing goods or services today finds his livelihood threatened, among other ways, by the competition created through the evolution of those new forms of distribution achieved by the horizontal or vertical integration of previously separate products or functions. Horizontally, the threat to existing merchandising patterns takes the form of integration in one business unit, or under common ownership, of what might be designated as unrelated lines of business or merely as the marketing of many goods or services instead of one or a limited number. Through vertical integration, the old-line seller is faced with combination in one unit of either production and distribution or the various stages of the distribution process itself.

To meet this competition, or the threat of it, resort is had to the legal weapon of protective legislation, though an attempt is made to disguise the real purpose in its use under the gaudy trappings of declarations that it is all done in the interest of protecting the public against practices dangerous to its health[2] or practices promotive of monopoly.[3] Such attack invites resistance, for the newly developing forms of dis-

* A.B., 1929, Goucher College; LL.B., 1932, Columbia University. Assistant Administrative Attorney, Marketing Laws Survey.

[1] For a discussion of the efforts of business to protect itself against this form of competition, see Silverman, Bennett and Lechliter, *Control by Licensing Over Entry into the Market*, *supra* this issue, an example of which is the adoption by mere occupational groups (barbers and beauty culturists, and other service trades) of a "professional" status with concomitantly stringent requirements set up for entry therein.

[2] See, *infra*, the discussion of legislation restricting the sale of food to food establishments, and the sale of drugs to registered pharmacists.

[3] See, *infra*, the discussion of restrictions on the retail merchandising of appliances by public utilities, on the ownership of theaters by motion picture producers, and on the wholesaling of groceries by the meat-packing companies.

tribution also have wanted to survive and grow. Here, too, we find the struggle clothed in gaudy phraseology of "personal liberties" and the right of free men to engage in all lawful pursuits. In speaking of the Missouri anti-department store law of 1899,[4] the then President of the American Bar Association said:[5]

> Did the lawmakers desire precedent for the attempted destruction of department stores, they could have found absolute prohibition of the carrying on of more than one business, under heavy penalties, among the discarded rubbish of the English law in statutes of the golden time when the might of kings controlled the right of subjects. It is unnecessary to state in this presence that long ago these impositions upon personal liberty were consigned, with many others of like import, to the dust heap.

No less immemorial is the struggle of the community to protect itself against the inordinate use of such weapons and counter-weapons, or against their use at all, where they may tend to give a certain class of men a monopoly of the trade without being sufficiently justified as a protection of public interest. That this struggle, too, is of ancient lineage, is eloquently witnessed by the proposition which the Emperor Zeno enacted in his constitution between 474 and 491 A.D.:[6]

> We decree that no one shall be permitted to exercise a monopoly in garments of any sort . . . nor in any commodity serving as food, or put to any other use, nor in any fabric, be it of his own accord or in pursuance of an existing or proposed imperial edict or pragmatic sanction of our written decree, and that no one shall enter into an unlawful association not to sell certain commodities more cheaply than agreed. (International Monthly, No. 5, January-June, 1902, pp. 478-479).

In a society which is rightly or wrongly based, at least theoretically, upon the idea of a free competitive economy,[7] one would assume that side would prevail which did not foster a monopoly or monopolistic tendencies. Such is not always the case. Each side hurls the accusation of monopoly at the other, and to a certain extent each is right. Integration in distribution, like concentration in production, can produce monopolistic power which may be used to stifle competition. On the other hand, legislation sponsored by established forms of marketing enterprise, attempting to prohibit or restrict horizontal or vertical integration, itself operates in a monopolistic manner, even though its proponents frequently attempt to justify it

[4] Mo. Acts 1899, p. 72, discussed at note 13, *infra.*

[5] (1927) 48 L. R. A. 261.

[6] See speech of Representative Littlefield on amendments to the Sherman Act, 36 CONG. REC. 1836 (1903).

[7] The attempt to foster such an economy is eloquently attested by the growth and existence of a large body of both state and federal anti-trust legislation, and the long line of judicial opinion upholding it. See National Cotton Oil Co. v. Texas, 197 U. S. 115, 129 (1904), in which, in upholding the anti-trust laws of Texas, the Supreme Court of the United States said: "It is enough to say that the idea of monopoly . . . the notion of exclusiveness . . . the suppression of competition by the unification of interest . . . is . . . the concern of the law to prohibit. . . . And this concern and the policy based upon it has not only expression in the Texas statutes; it has expression in the statutes of other states and in a well-known national enactment. According to them, competition, not combination, should be the law of trade. If there is evil in this it is accepted as less than that which may result from unification of interest, and the power such unification gives. And that legislatures may so ordain this court has decided."

with the very argument that it is devised to prevent monopolistic practices.[8] Necessarily, a law which attempts to restrict to a certain class of men the privilege of marketing certain products, is giving such class a monopoly of that trade,[9] and setting up legislative barriers against the entrance of one-time outsiders therein. It would seem, therefore, that the courts would frown upon such legislative monopolies. Such, however, has not always been the result in cases testing the legality of such restrictive legislation. Broad concepts of state police power and the well-known judicial reluctance to invalidate a statute allegedly enacted under such power, come into operation.[10] If the control sought by the legislation can be related "reasonably"[11] to the preservation of the public health, safety, morals or general welfare, the courts will approve it, thus perpetuating a limited monopoly in favor of established forms of business.

PRODUCT INTEGRATION

Legal action aimed at preventing the integration in one marketing unit of lines or products formerly marketed by separate types of business concerns has taken several forms: (1) the abortive anti-department store laws of the late nineteenth century; (2) restrictions on the retailing of appliances by public utilities; (3) an interpretation of the language of the Sherman Act to prohibit the vending of "groceries" by those engaged in the meat-packing industry; (4) the recent restaurant laws designed to protect the restaurateur from the competition of low-cost, tipless meals served by drugstores and five-and-tens; (5) restrictions on motor vehicle dealers engaging in any other line of business; (6) restrictions on the retailing of alcoholic beverages in connection with other types of commodities; (7) a long history of pharmacy laws restricting the sale of nearly all kinds of drugs and medicines to registered pharmacists; and (8) the recent move to restrict certain product integrations among chains by including such multiple-line chains within the chain-store tax laws while excluding single-line chains.

The first indication of a move to "go after" department stores was revealed in two rather mild-appearing laws enacted in 1897, one in Indiana and one in Wisconsin. These laws[12] merely contained statutory authorization to cities to license

[8] See note 3, *supra*.

[9] See State v. Donaldson, 41 Minn. 74, 42 N. W. 781 (1889), which held invalid a provision of a pharmacy law restricting the sale of drugs and medicines to registered pharmacists. Since there was no exemption even for patent medicines, although the pharmacist was expressly exempted from liability for their quality, the court said such a complete prohibition was not designed to protect the public health but to create a monopoly in favor of the pharmacists. See, *infra*, the discussion of legislation restricting the retailing of drugs.

[10] See Paramount Pictures, Inc. v. Langer, 23 F. Supp. 890 (D. N. D. 1938); S. H. Kress & Co. v. Johnson, 16 F. Supp. 5 (D. Colo. 1936), *aff'd per curiam*, 299 U. S. 511 (1936); *cf.* Crescent Cotton Oil Co. v. Mississippi, 257 U. S. 129 (1921) (integration in production).

[11] See the long line of decisions originating with Powell v. Pennsylvania, 127 U. S. 678 (1888), through Lindsley v. Natural Carbonic Gas Co., 220 U. S. 61 (1911); Price v. Illinois, 238 U. S. 446 (1915); Rast v. Van Deman & Lewis Co., 240 U. S. 342 (1915); Standard Oil Co. v. City of Marysville, 279 U. S. 582 (1929); O'Gorman & Young, Inc. v. Hartford Fire Ins. Co., 282 U. S. 251 (1931); Nebbia v. New York, 291 U. S. 502 (1934); S. H. Kress & Co. v. Johnson, *supra* note 10.

[12] Ind. Laws, 1897, c. 70; Wis. Laws, 1897, c. 373.

and regulate department stores, but such special authorization seems to indicate an attempt to empower municipalities to impose heavier exactions than could be justified under their general licensing or taxing powers. In neither of these states does there appear to have been any judicial test of these statutes.

A far more outspoken Missouri enactment[13] of 1899 and a contemporaneous Chicago ordinance of like purport were, on the other hand, promptly held invalid.[14] The state law divided merchandise into a certain number of classes which were rearranged into groups, and anyone employing more than 15 persons was prohibited from selling goods from more than one of the several classes or groups without paying a license fee of from $300 to $500 for each group, no fee being required for sales from only one group. The Chicago ordinance prohibited any meats, fish, butter, or other provisions from being sold "where dry goods, clothing, jewelry, and drugs are sold." Such laws were so obviously self-interest legislation procured by the small single-line merchants in an attempt to protect themselves against the development of the multiple-line department store, that the courts did not even attempt to find justification for them.[15]

Since the early 1930's numerous bills have been introduced in state legislatures to prohibit public utilities from selling gas and electrical appliances to their customers.[16] However, only two have succeeded in enactment, one in Kansas and one in Oklahoma.[17] The Oklahoma statute has not been litigated, but the Kansas law was promptly held invalid by the supreme court of the state.[18] After determining that appliance sales are a natural incidence of a utility's power to sell and distribute

[13] See note 4, *supra*.

[14] State *ex rel.* Wyatt v. Ashbrook, 154 Mo. 375, 55 S. W. 627 (1900); Chicago v. Nechter, 183 Ill. 104, 55 N. E. 707 (1899). The authority claimed for the Chicago ordinance, which was obviously aimed at department stores, was the statutory power of the city to regulate the sale of meats and all other provisions. See, *infra,* note 65 and text for the provisions of this ordinance, likewise judicially condemned, prohibiting the sale of packaged liquors in such stores.

[15] In striking down the Missouri law, the court said: ". . . no reason has been given or suggested, and to our minds, none can be conceived why the arbitrary selection of persons . . . having . . . for sale, in the same store or building, under a unit of management or superintendency, at retail, . . . any articles or goods, . . . of more than one of the several classifications or groups . . . designated, when 15 or more people are employed, was . . . made, for the imposition of the license fee . . . from which all other persons and merchants of the State are exempted." State *ex rel.* Wyatt v. Ashbrook, *supra* note 14, at 395-396, 55 S. W. at 632. Compare, the judicial attitude toward the so-called restaurant laws, discussed *infra,* and revealed in S. H. Kress & Co. v. Johnson, *supra* note 10.

[16] Legis. (1937) 22 IOWA L. REV. 736, 741; *Merchandising Electrical Appliances,* A Report of the Electrical Merchandising Joint Committee (1933). The National Electrical Manufacturers Association, in a letter dated March 3, 1941, states that in the last four years, 1937-1940, 21 bills were introduced in various states, but none enacted, and that to date in 1941 bills have been introduced in Connecticut and Massachusetts.

[17] KAN. GEN. STAT. (Corrick, 1935) §66-1210; OKLA. STAT. ANN. (1936) tit. 18, §72. "It shall be unlawful for any public service corporation in this state, directly or indirectly, to engage in the sale of merchandise, utensils, or chattels of any sort not directly connected with the general business of such public service corporation as authorized by its charter, except as herein before provided. Nothing herein shall be construed to prohibit any public service company from selling fuse plugs, electric light bulbs, outlet plugs, sockets, extension cords, or other repairs or equipment necessary to maintain continuity of service to any patron or patrons of such Company." *Ibid.*

[18] Capital Gas & Electric Co. v. Boynton, 137 Kan. 717, 22 P. (2d) 958 (1933).

gas, electricity and other public utility services,[19] the court held that the statute "appears to be strictly class legislation without any reasonable relation to the welfare of the public."[20] Proponents of the legislation attempted to argue that it was designed "to prevent a monopoly," and therefore justified as an exercise of the police power in the interests of the general welfare of the public. The Kansas court decided, however, that the effect of the law was to create a monopoly rather than to prevent one. "The obvious result of the enactment . . . would be to limit the sale of such appliances to merchants and others. . . ." With no feature of public interest therefore involved, to single out the utilities as a class and forbid them to merchandise appliances was held to deny them arbitrarily the equal protection of the laws. It should be noted that this decision was rendered in spite of the fact that the evidence showed the utility companies sold from 80 to 90 percent of the gas appliances in the communities where they operated and in connection with such sales performed certain functions and rendered certain services[21] which only their size and position as a utility permitted them to do, and which, therefore, the regular appliance dealers complained they could not match.[22]

So here we have the legal seal of approval placed upon two developments of multiple-line organization, whereas other attempts at integration of so-called unrelated lines have been condemned as productive of monopolistic power. Such condemnation was achieved through application of the general language of the Sherman Act to the activities of the great meat-packing companies of the country, Swift, Armour, Morris, and Cudahy. A consent decree was entered against these companies in 1920,[23] by the terms of which a monopolistic combination of the companies was dissolved and the units that composed it were individually enjoined, among

[19] The courts of the country are almost universally in accord with this view: Hamler v. City of Jacksonville, 97 Fla. 807, 122 So. 220 (1929); Holten v. City of Camilla, 134 Ga. 560, 68 S. E. 472 (1910); Andrews v. City of South Haven, 187 Mich. 294, 153 N. W. 827 (1915); Milligan v. Miles City, 51 Mont. 374, 153 Pac. 276 (1915); Malone v. Lancaster Gas Light & Fuel Co., 182 Pa. 309, 37 Atl. 932 (1897); Commonwealth *ex rel.* Baldridge, Atty. Gen. v. Philadelphia Electric Co., 300 Pa. 577, 151 Atl. 344 (1930); Erie Lighting Co. *et al.* v. Penn. Public Utility Comm., 113 Pa. Super. 190, 198 Atl. 901 (1938).

[20] Capital Gas & Electric Co. v. Boynton, *supra* note 18, at 729, 22 P. (2d) at 964.

[21] Such as (1) liberal allowances for used appliances which bore no exact relation to the value thereof; (2) free servicing of the appliances; and (3) charging up the loss in the operation of the appliance department as an operating expense of the company so that it became a factor in its utility rate structure. Capital Gas & Electric Co. v. Boynton, *supra* note 18, at 723-724, 22 P. (2d) at 961. See also Andrews v. City of South Haven, *supra* note 19; Keen v. City of Waycross, 101 Ga. 588, 29 S. E. 42 (1897). Pennsylvania attempted to remedy this situation in 1937 by enacting a law which, instead of prohibiting utilities from selling appliances, regulates certain practices in connection with such sales. PA. STAT. ANN. (Purdon, Supp. 1940) tit. 66, §1352, prohibiting the utility from discontinuing utility service to a consumer for failure to pay for appliances, forbidding it to apply to the purchase price thereof any consumer deposit, and requiring separate accounts concerning its appliance sales. Several other states also require the keeping of separate accounts. ILL. REV. STAT. (Smith-Hurd, 1939) c. 111 2/3, §12; S. C. CODE (Supp. 1934) §8555-2(16); WASH. REV. STAT. ANN. (Remington, Supp. 1939) §10458-2; WIS. REV. STAT. (1939) §196.59.

[22] Contrast the judicial attitude displayed in Paramount Pictures, Inc. v. Langer, *supra* note 10.

[23] The decree was entered in 1920 in the Supreme Court of the District of Columbia, sitting in equity.

other things, from continuing to trade, either at wholesale or retail, in so-called groceries, *i.e.* in certain unrelated foodstuffs not within the scope of the meat-packing industry.[24]

The reasons maintained by the government for the prohibitions of this decree were twofold. The first was that through the ownership of refrigerator cars and branch houses as well as other facilities, the companies were in a position to distribute these foods and other unrelated commodities with substantially no increase in overhead. Secondly, that they fixed prices for groceries so low over temporary periods of time that the competition of less favorably situated rivals was eliminated and they were enabled to establish a monopoly of a large part of the food supply of the nation.[25]

In the two cases involving this decree which reached the Supreme Court of the United States,[26] the Court refused to disturb it, thus leaving in effect the requirement for divorcement of lines. It is important to note here that the decree prohibited the individual companies from engaging in such unrelated lines of business, "upon the theory that even after the combination among the packers had been broken up and the monopoly dissolved, the individual units would be so large that the capacity to engage in other forms of business as adjuncts to the sale of meats should be taken from them altogether."[27] Here, then, we have the Sherman Act being used, with the specific recognition of the Court, to protect an established class of business, the wholesale grocers and produce dealers.[28]

However, it is arguable whether either one of the *Swift* cases is necessarily persuasive of the point that the language of the Sherman Act can be used to prohibit such product integration. In neither case was the Court passing directly upon the

[24] More specifically, it enjoined the defendants, without consent of the court, (1) from engaging or being interested in the business of manufacturing, buying, selling or handling any one of 114 enumerated food products or any one of 30 other named articles of commerce; (2) from selling milk or cream; (3) from selling meat at retail; and (4) from using their distributive systems (including branch houses, refrigerator cars, route cars, and auto trucks) in any manner for the purpose of handling any of the many articles referred to. For other aspects of this decree, see the discussion, *infra,* of restrictions on vertical forms of integration.

[25] See United States v. Swift & Co., 286 U. S. 106 (1932). Compare this with the attitude expressed in Capital Gas & Electric Co. v. Boynton, *supra* note 18, in which the Kansas high court invalidated the prohibition on the marketing of appliances by public utilities, in spite of the fact that the very reasons for which the regular retail dealers sponsored the law were bottomed on what they claimed were the unfair competitive advantages which the size of the utilities gave them in such merchandising. See Nelson-Johnston & Dowdna v. Metropolitan Utilities Dist., 291 N. W. 558 (Neb. 1940). Added to such competitive advantages there was the objection, not present in the meat packing case, that the utilities engage in appliance sales not for their own sake, but merely as a means to load-building, and therefore can afford to operate their appliance departments at a loss by absorbing such loss in their utility business. See (Mar. 11, 1939) 111 ELECTRICAL WORLD 689; Capital Gas & Electric Co. v. Boynton, *supra* note 18.

[26] Swift & Co. v. United States, 276 U. S. 311 (1928); United States v. Swift & Co., *supra* note 25.

[27] United States v. Swift & Co., *supra* note 25, at 116.

[28] "The question is . . . whether a modification as to groceries can be made [in the decree] without prejudice to the interests of the classes whom this particular restraint was intended to protect . . . wholesale grocers." United States v. Swift & Co., *supra* note 25, at 117, 118. It should be noted here, of course, that the law has today established that the fact a statute is passed primarily in the interests of a class, will not of itself render such statute invalid. Nebbia v. New York, *supra* note 11; Borden's Farm Products Co. v. Ten Eyck, 297 U. S. 251 (1936); Paramount Pictures, Inc. v. Langer, *supra* note 10.

correctness of the inclusion within the consent decree of such a prohibition. The 1928 case came up on a motion of Swift and Armour to vacate the decree and declare it void. Consequently, said the Court, the question was merely whether the original court had the power to render such a decree at all. This question it answered affirmatively and then went on to say that the defendants, by consenting to the entry of the decree, had waived any error in decision.[29]

The 1932 case came before the Court in an effort of Swift and Armour to secure a modification of the consent decree to permit the wholesaling of groceries. In refusing to disturb the decree, the Court emphasized that the question was not one of reviewing the decree to determine whether it was right or wrong originally, but whether, having been made to include the collateral lines of trade with the consent of each defendant, it should now be relaxed because of changed conditions. In determining that sufficiently changed conditions did not exist, the Court said:[30]

> We do not turn aside to inquire whether some of these restraints upon separate as distinguished from joint action could have been opposed with success if the defendants had offered opposition. Instead, they chose to consent, and the injunction, right or wrong, became the judgment of the Court.

Closely akin to the anti-department store laws are the recent "restaurant" laws enacted by Colorado and Wisconsin.[31] Obviously designed to protect the restaurant from the competition of meals served by drugstores and five-and-tens, they achieve this by prohibiting a restaurant from being operated in the same room with any other business. But this time the judicial seal of approval was placed upon the restriction and not upon the new form of distribution.[32] The Colorado law was construed, in two request opinions of the Colorado Supreme Court,[33] as not prohibiting anyone engaged in another business from also engaging in the restaurant business, but as merely requiring, if he wishes to be both merchant and restaurateur, that he conduct the businesses in separate rooms. It further held that physical connections between such rooms, such as connecting doors, were permissible.[34]

[29] ". . . had the defendants not waived such error by their consent, they might have had it corrected upon appeal." Swift & Co. v. United States, *supra* note 26, at 331.

[30] United States v. Swift & Co., *supra* note 25, at 116, 117.

[31] COLO. STAT. ANN. (Michie, 1935) c. 81, §§13-24; WIS. CODE (1939) §§160.01-160.08. Three similar bills were introduced in the New York legislature in 1940 but were not enacted. Furthermore, a bill has been introduced in the present session of the South Dakota legislature, H. B. No. 122 (1941), which would impose a $10 license tax on separate grocery and butcher shops, a $1,000 license tax on combined grocery and meat stores.

[32] S. H. Kress & Co. v. Johnson, *supra* note 10.

[33] *In re* Interrogatories of the Governor, 97 Colo. 587, 52 P. (2d) 663 (1935), rendered at the request of the Governor of Colorado, defendant in a suit by Kress & Co. and others, to restrain enforcement of the law. S. H. Kress & Co. v. Johnson, *supra* note 10.

[34] It should be noted that the Wisconsin law in specific terms provided that a restaurant could be conducted on the same premises as other businesses if separated therefrom by ceiling-high partitions and self-closing doors. The Colorado law, however, provided: ". . . it shall be unlawful . . . to sell . . . 'food' for consumption on the premises except . . . in a licensed 'restaurant,' as defined. . . . 'Restaurant' shall mean an establishment . . . whose principal business is the sale of meals, and in which room nothing is sold excepting meals, food, drink and tobaccos. Any establishment connected with any business whatsoever . . . wherein any business is conducted excepting the sale of meals, . . . is hereby declared not to be a restaurant."

Adopting this interpretation of the Colorado law as conclusive and framing the issue after the manner of current judicial technique in such cases,[35] the federal district court, in a decision subsequently affirmed *per curiam* by the United States Supreme Court, succeeded in justifying the measure as one reasonably designed to protect the public health.[36]

In doing so, the court held that against the constitutional argument of lack of due process the presumption of constitutionality must prevail in favor of a statute allegedly enacted in the protection of some public interest, here the public health, even where there is a sharp conflict of opinion among experts in the field as to whether it will tend to protect such public interest, if there is some substantial evidence to support the view that it will. "It is plainly not enough that the subject should be regarded as debatable. If it be debatable, the legislature is entitled to its own judgment. . . ."[37] This test of reasonableness is to be compared with that enunciated in *O'Gorman & Young, Inc. v. Hartford Fire Ins. Co.*,[38] in which the Court held that the presumption of constitutionality must prevail in favor of a statute allegedly enacted under the police power, when "the record is barren of any allegation of fact tending to show unreasonableness."[39]

However, the apparent liberality of these rules in testing the constitutionality of non-integration legislation, is limited by several factors. In the first place, in both the *Kress* and *O'Gorman* cases the Court was assisted by the fact that the statute on its face dealt with a general subject previously established as within the power of the state to regulate.[40] Since the end, or policy, declared by the statute in each case was lawful on its face, the question was therefore stated to be, merely whether the specific means provided were "reasonably" adapted to achieve this lawful end.[41]

Hence if a non-integration statute does not on its face deal with a subject which a court can recognize as having been established as within the police power, wit-

[35] See text and notes 10 and 11, *supra*.

[36] S. H. Kress & Co. v. Johnson, *supra* note 10. In affirming the decision of the district court, the United States Supreme Court wrote no opinion, but merely cited as authority for its action, Powell v. Pennsylvania, 127 U. S. 678 (1888) (upholding oleomargarine tax law); Price v. Illinois, 238 U. S. 446 (1915) (upholding prohibition on food preservative containing boric acid); Standard Oil Co. v. City of Marysville, 279 U. S. 582 (1929) (upholding ordinance prohibiting storage of gasoline above ground); (4) Nebbia v. New York, 291 U. S. 502 (1934) (upholding minimum price fixing of milk).

[37] S. H. Kress & Co. v. Johnson, *supra* note 10, at 8. See also Rast v. Van Deman & Lewis Co., *supra* note 11, for an application of the same test in 1915 in the *Trading Stamp* case.

[38] *Supra* note 11.

[39] *Id.* at 258; ". . . the presumption of constitutionality must prevail in the absence of some factual foundation of record for overthrowing the statute. It does not appear upon the face of the statute, or from any facts of which the court must take judicial notice, that . . . evils did not exist . . . for which this statutory provision was an appropriate remedy." *Id.* at 257, 258.

[40] In the *Kress* case, with the regulation of the serving of food by restaurants in the interests of the public health; in the *O'Gorman* case, with the regulation of the rates of insurance companies in the interest of public welfare, see German Alliance Insurance Co. v. Lewis, 233 U. S. 389, 412 (1913).

[41] S. H. Kress & Co. v. Johnson, *supra* note 10, at 7, the means in this case being the requirement that a restaurant be conducted in a separate room from any other business; O'Gorman & Young, Inc. v. Hartford Fire Ins. Co., *supra* note 11, at 257, the means here being the requirement that no fire insurance company could allow a commission to any person acting as its local agent respecting such insurance, in excess of that allowed to any of its local agents on such risks in the state.

ness the anti-department store laws[42] and the public utility anti-merchandising laws,[43] it must do more than apply one of the tests enunciated in the *O'Gorman* and *Kress* cases. In addition to deciding the question of means, a court must first decide the question of legislative power, or in other words, whether the end sought is within the jurisdiction of the legislature as an exercise of the police power.[44]

Another possible limitation to the liberal application of the test in the *Kress* case is the fact that the federal district court, despite its statements that it is not within the province of the judiciary to disturb a legislative finding if there is evidence to support it, even where "the evidence leaves the question . . . fairly debatable," itself regarded the restriction as one likely to preserve the public health.[45]

Then again, a non-integration statute might be struck down as offending the equal protection clause. Although courts are extremely liberal in determining the question of reasonable classification,[46] the classification set-up to protect the special interest may be so arbitrary that a court will be unable to find any relation to the public health. This was the situation in the early Illinois decision[47] invalidating the Chicago anti-department store ordinance to which previous reference has been made. Although the ordinance purported to deal with a subject within the scope of the police power, the regulation of food in the protection of the public health, it did not require meat and other provisions to be sold only by meat and provision stores, and did not prohibit all merchandise dealers from selling meat and provisions. Rather, it merely singled out those carrying certain lines of commodities, in other words, department stores. The distinction was therefore arbitrary, in the opinion of the Illinois court. A further instance of similar judicial reaction is to be found, it will be recalled, in the case invalidating the Kansas anti-utility merchandising act.[48]

Three states, Ohio, New Hampshire and Vermont,[49] have laws which can be construed to prohibit motor vehicle dealers from combining any other line of business with that of the sale of motor vehicles. The Ohio provision is the most conclusive in that it would seem specifically to prohibit such integration by providing

[42] See discussion and notes 14 and 15, *supra.*

[43] See discussion and notes 17, 18 and 20, *supra.*

[44] See notes 40 and 41, *supra.* It should be noted here, however, that the court was required to answer both questions in Paramount Pictures, Inc. v. Langer, *supra* note 10, in determining the validity of a law prohibiting motion picture producers and distributors from owning or operating motion picture theaters in the state, and answered them both affirmatively. See discussion and note 118, *infra.* Compare, however, the decisions concerning the anti-department store and anti-utility merchandising laws.

[45] S. H. Kress & Co. v. Johnson, *supra* note 10, at 7, 8.

[46] ". . . it is established that a distinction in legislation is not arbitrary, if any state of facts reasonably can be conceived that would sustain it, and the existence of that state of facts at the time the law was enacted must be assumed." Rast v. Van Deman & Lewis Co., *supra* note 11, at 357; Lindsley v. Natural Carbonic Gas Co., *supra* note 11. Followed in S. H. Kress & Co. v. Johnson, *supra* note 10, at 9.

[47] Chicago v. Nechter, *supra* note 14. See also State *ex rel.* Wyatt v. Ashbrook, *supra* note 14.

[48] Capital Gas & Electric Co. v. Boynton, *supra* note 18.

[49] OHIO GEN. CODE (Baldwin's Throckmorton, 1940) §§6302-1 to 6302-3; N. H. Laws 1939, c. 47, amending N. H. PUB. LAWS (1926) c. 99, §1, ¶4; Vt. Laws 1937, act 113, amending VT. REV. PUB. LAWS (1933) §4986.

that licenses required of all dealers will be denied to any dealer who does not have an "established place of business which is used . . . solely and exclusively for . . . dealing in motor vehicles."[50] Such prohibition is further supported by a definition of the term "dealer" as meaning "all persons . . . regularly engaged in the business of selling . . . motor vehicles at an established place of business which is used solely and exclusively for . . . selling . . . motor vehicles."[51] The only exemption from the prohibition is the maintenance, in connection with such establishment, of repair, accessory, gasoline and oil, storage, parts, service or paint departments, if operated "for the purpose of furthering and assisting in the business of selling . . . motor vehicles."[52]

Although the New Hampshire and Vermont statutes[53] define the term motor vehicle "dealer" in language almost identical with that of Ohio,[54] such definitions are not part of, or applicable to, any law requiring the licensing of such dealers. Instead, they are part of the regular motor vehicle law and seem to be included primarily for purposes of the provisions concerning the issuance of dealers' registration plates. As a part of such law, however, the definition necessarily limits the issuance of special dealer plates to those dealers who maintain a place of business devoted exclusively to the motor vehicle business. Whether the limitation in connection with such registration-plate provision would successfully operate to keep motor vehicle dealers from engaging in any other line of business remains an open question, for neither of these provisions, nor the Ohio prohibition, has yet been litigated. However, assuming that they were construed so to operate, and certainly the Ohio provision is mandatory, it is difficult to see how the courts could find any aspect of the public health, safety, morals or general welfare sufficiently present to sustain them.

In the field of alcoholic beverages, eleven states,[55] not taking into consideration those operating a state monopoly, provide some form of legislative restriction on the package retailing of such beverages in connection with other lines of business. Indiana and Rhode Island limit the sale of "hard" liquors by the package to drug and exclusively liquor stores;[56] New Hampshire and certain counties of Maryland, to drug and grocery stores;[57] Missouri to drug, grocery, tobacco, delicatessen and general merchandise stores;[58] New York to exclusive liquor stores, permitting beer to be retailed only by drug and grocery stores;[59] while New Jersey authorizes her

[50] OHIO GEN. CODE (Baldwin's Throckmorton, 1940) §6302-3.

[51] *Id.* §6302-1. [52] *Id.* §6302-3. [53] Cited *supra* note 49.

[54] N. H.: "Dealer: every person . . . in the business of . . . selling . . . motor vehicles . . . who maintains a *place of business devoted exclusively* to the motor vehicle business. . . ." Vt.: "Dealer: . . . a person actively engaged in . . . the business of . . . selling . . . motor vehicles . . . who *maintains a salesroom or garage devoted exclusively* to the motor vehicle business. . . ."

[55] Ind., Md., Mich., Minn., Mo., N. H., N. J., N. Y., Ohio, Pa., R. I.

[56] IND. STAT. ANN. (Burns, Supp. 1940) §12-518; R. I. Laws 1933, c. 2013, §5B, as amended by R. I. Laws 1936, c. 2338, §1.

[57] N. H. Laws 1933, c. 99, §9; MD. CODE ANN. (Flack, 1939) art. 2B, §§6, 30.

[58] MO. STAT. ANN. (Supp. 1940) §4525g-26.

[59] N. Y. ALCOHOLIC BEVERAGE CONTROL LAW §§54(4), 63(4), 79.

cities to limit such sales to exclusively liquor stores.[60] Pennsylvania, which operates a state monopoly system for the retailing of "hard" liquors and wines, permits the retailing of malt beverages by private business concerns, but in so doing limits such sales to hotels and restaurants.[61]

Although there is little judicial authority on the constitutionality of such restrictive provisions as applied to alcoholic beverages, what does exist is almost wholly favorable.[62] As recently as 1937, the Supreme Court of Illinois upheld an ordinance prohibiting retail grocery stores and meat markets from selling malt beverages in bottles or sealed containers "for consumption on the premises."[63] In doing so, the Illinois court declared that prohibiting such integration of lines only to grocery and meat stores and not to business concerns marketing other types of commodities, does not create such an arbitrary classification as to render the provision unconstitutional. The purchase of meats and food products being almost a daily necessity, it may be to the good of the city, reasoned the court, to guard women and children from close contact with the sale of alcoholic beverages:[64]

> While we might differ with the views of the city council as to any injurious results traceable to the sale of malt liquor . . . in the designated class of dealers, it . . . is not within our province to substitute our views for those of the legislative department. . . .

It should be noted that the prohibition involved in this case was against sales for consumption on the premises, and not package sales for off-premise consumption. It was on this basis that the court attempted to distinguish the case from the early decision of *Chicago v. Nechter*[65] which invalidated as discriminatory an ordinance prohibiting intoxicating liquors from being sold by the package in any place of business retailing "dry goods, clothing, jewelry or hardware."

However, such a restriction as applied to package sales was upheld as recently as 1935, in a case[66] which declared valid an ordinance prohibiting retail liquor dealers from engaging in the mercantile or drug business in the same building in which they operated their liquor business.[67]

> It is apparent that the owner of the two businesses so located may take advantage of this condition to increase the sales of intoxicating liquors to the public in ways . . . he could not employ if the businesses were otherwise located . . . and while it is possible that the ordinance . . . may not be based on the soundest sort of wisdom and reason, yet it has sufficient foundation to make it a matter within the scope of legislative authority.

[60] N. J. STAT. ANN. (1940) §33:1-12.

[61] PA. STAT. ANN. (Purdon, Supp. 1940) tit. 47, §744-412.

[62] Great A. & P. Tea Co. v. Mayor of Danville, 367 Ill. 310, 11 N. E. (2d) 388 (1937); Tittsworth v. Akin, 118 Fla. 454, 159 So. 779 (1935); Sloan v. Hutchingson, 120 Fla. 747, 163 So. 61 (1935); Peer v. Board of Excise, 70 N. J. L. 496, 57 Atl. 153 (1904); Jacobs Pharmacy Co. v. City of Atlanta, 88 Fed. 244 (C. C. N. D. Ga., 1898).

[63] Great A. & P. Tea Co. v. Mayor of Danville, *supra* note 62. *Cf.* Chicago v. Nechter, *supra* note 14, and discussion of anti-department store laws.

[64] *Id.* at 318, 11 N. E. (2d) at 392.

[65] *Supra* note 14. See, also, the discussion of this case in connection with the anti-department store laws, *supra*.

[66] Tittsworth v. Akin, *supra* note 62.

[67] *Id.* at 463, 159 So. at 782.

An 1898 federal case[68] upheld an ordinance prohibiting the sale of liquors by drug stores. Finally, in *Peer v. Board of Excise*[69] the validity of a restriction of this type was apparently assumed, when the New Jersey court held that the issuance to a grocery store of a retail liquor license was a violation of a statute prohibiting such licenses to stores in which a grocery or other mercantile business is carried on.[70]

The field of drugs perhaps boasts the longest history of legislation prohibiting distribution of a certain line of products by those engaged in other lines of business. It is well known that all states, as a public health measure, regulate in some manner the sale of drugs, medicines and poisons. Among other regulatory provisions, nearly all states restrict the sale of such commodities to registered pharmacists. The ostensible justification for such a restriction is, of course, the protection of the public health on the theory that the retailing of drugs and similar products should be limited to those specially trained and skilled in the subject of pharmacy and drugs.[71] Such an absolute restriction is certainly justified in connection with the compounding of prescriptions. But what of the hundreds of drugs which are today so standardized that they are merely sold over the counter in the manufacturer's original package as any ordinary piece of merchandise?[72] Add to this the fact that nearly all state pharmacy laws exempt from their terms the sale of so-called patent or proprietary medicines and sometimes what are designated as ordinary household remedies, and there seems to be no justification on the ground of public health for prohibiting merchants other than pharmacists from selling standardized products in the original package of the manufacturer.[73] This conclusion seems even more necessary when consideration is given to the fact that many of the pharmacy laws provide that a pharmacist shall not be held responsible for the quality of drugs sold in the original package.[74] Furthermore, even though the pharmacy law itself may contain no such provision, nearly all state pure food and drug laws carry the usual clause exempting dealers from liability when they can establish a written guaranty from the manufacturer or distributor.[75]

These facts are perhaps best illustrated by the recent history of the Montana pharmacy act, which prior to 1939 contained a provision[76] limiting to registered pharmacists the retail sale of all drugs and medicines except patent or proprietary medicines in the original package, when plainly labeled. The Montana Supreme

[68] Jacobs Pharmacy Co. v. City of Atlanta, *supra* note 62.

[69] *Supra* note 62.

[70] See, also, Sloan v. Hutchingson, *supra* note 62, for a dictum supporting the legality of such non-integration measures.

[71] See State v. Stephens, 102 Mont. 414, 59 P. (2d) 54 (1936); Kentucky Bd. of Pharmacy v Cassidy, 115 Ky. 690, 74 S. W. 730 (1903).

[72] See, Kentucky Bd. of Pharmacy v. Cassidy, *supra* note 71, at 706, 74 S. W. at 734: "It requires no more scientific skill to do so than to sell soap or perfumery, or any other like articles. . . ."

[73] See State v. Stephens, Kentucky Bd. of Pharmacy v. Cassidy, both *supra* note 71; Arizona v. Childs, 32 Ariz. 222, 257 Pac. 366, 54 A. L. R. 736 (1927); State v. Donaldson, *supra* note 9.

[74] *E.g.*, ARIZ. CODE ANN. (1939) §67-1518; N. M. STAT. ANN. (Courtright, 1929 and Supp. 1938) §§103-108; N. C. CODE (Michie, 1939) §6665.

[75] See, OKLA. STAT. ANN. (1936) tit. 63, §260; PA. STAT. ANN. (Purdon, Supp. 1940) tit. 35, §791. Other states with similar provisions are R. I., S. C., Va., Wyo.

[76] MONT. REV. CODES (Anderson & McFarland, 1935) §§3170, 3181, 3184.

Court held this provision to be unconstitutional because it prevented a grocer from selling aspirin.[77] Such a prohibition, declared that court, does not appear to preserve the public health in any way since no act of skill or special knowledge is involved in the sale of a standard article like aspirin. Moreover, the pharmacy law itself contained a provision absolving the pharmacist from responsibility for the quality of drugs when sold in the original packages of the manufacturer.[78] Therefore, reasoned the court, there is no justification for restricting the sale of such articles to registered pharmacists only.[79] Another court, invalidating a similar provision, said:[80] "It would be giving pharmacists a monopoly of the business, without in any manner protecting the public health."

Some 21 states[81] contain provisions in their pharmacy laws which operate to prohibit the sale of aspirin by other than registered pharmacists. The same is true of many standard medicines, for few states exempt from the registered pharmacist restriction any articles other than patent or proprietary medicines and a rather standardized list of common household remedies such as alum, aromatic spirits of ammonia, bay rum, bicarbonate of soda, epsom salts, castor oil, glycerine, essence of peppermint, peroxide of hydrogen, witch-hazel and similar products.[82]

In the field of chain merchandising are to be found certain forms of horizontal or product integration that are restricted or penalized without an equivalent burden being placed upon either single-line chains or independent stores. This discrimination is effected by exempting from the chain-store tax laws certain product chains only if the sale of such product constitutes the chain's exclusive, or in some instances, principal, business. The best known of such exemptions is that granted to pure filling stations, *i.e.* stations selling gasoline exclusively.[83] Such a provision necessarily penalizes those stations which also deal largely in accessories while not placing a similar

[77] State v. Stephens, *supra* note 71.

[78] MONT. REV. CODES (Anderson & McFarland, 1935) §3184.

[79] *Accord:* Kentucky Bd. of Pharmacy v. Cassidy, *supra* note 71; Arizona v. Childs, State v. Donaldson, both *supra* note 73. Montana amended its pharmacy law in 1939 to permit the sale of drugs "prepared in sealed packages or bottles by a manufacturer, qualified under the laws of the state where the manufacturer resides." MONT. REV. CODES (Anderson & Wertz, Supp. 1939) §3177.1. Query, as to whether the use of the term "sealed" would limit the effectiveness of this exemption. Furthermore, it should be noted that Montana repealed the section absolving the dealer from responsibility for the quality of drugs sold in the manufacturer's original packages. The new section regulating the quality of drugs now provides merely that nothing in the state pure food and drug act shall be changed by the pharmacy law. *Id.* §3187.3. The pure food law contains the usual exemption clause for dealers establishing written guaranties. MONT. REV. CODES (Anderson & McFarland, 1935) §2588.

[80] State v. Donaldson, *supra* note 9, at 83, 42 N. W. at 783.

[81] Ariz., Calif., Colo., Ill., Ind., Iowa, Mass., Mich., Minn., Mo., Nev., N. H., N. J., N. M., N. Y., N. C., N. D., Ohio, S. D., Wis., Wyo.

[82] See ARIZ. CODE ANN. (1939) §§67-1506, 67-1513, 67-1514; ORE. COMP. LAWS ANN. (1940) §§58-103, 58-107; N. C. CODE (Michie, 1939) §6667.

[83] Fla., Idaho and Minn. exempt pure filling stations. FLA. COMP. GEN. LAWS (Skillman, Supp. 1936) §415 (95b); Idaho Laws 1933, c. 113, §7; MINN. STAT. (Mason, Supp. 1940) §5887-18b. Ga., Md., Mich. and Miss. exempt dealers whose "principal business" is the sale of gasoline or petroleum products. GA. CODE ANN. (Park, *et al.*, 1936) §92-1602; MD. ANN. CODE (Flack, 1939) art. 56, §65; MICH. STAT. ANN. (Henderson, 1936) §7.482; MISS. CODE ANN. (Supp. 1938) §774. Texas exempts stores selling and distributing petroleum products and servicing motor vehicles. Tex. Laws 1st Ex. Sess. 1935, c. 400, §5.

burden upon independent tire and battery stores. There is also the exemption found in the Iowa chain-store tax law[84] which is granted to retailers of coal, ice, lumber, grain, feed and building material provided 95 percent of their total receipts derive from sales of one or more of those products. With only minor variations, Minnesota and South Dakota provide exemption clauses almost identical with that of Iowa.[85] Whatever the purpose in the enactment of these exemption clauses, it is clear that one of their effects is to favor non-integration of products when the business is done on a chain basis.[86]

VERTICAL INTEGRATION OF DISTRIBUTING UNITS

Not only have the legislatures been active in prohibiting and restricting forms of horizontal integration among distributors; activity on behalf of the old-line merchant has extended to prohibition of the vertical integration of the distributing units themselves. Such legislative restrictions are most evident in the field of alcoholic beverages, 32 states prohibiting wholesalers of such beverages from engaging in retail sale.[87] With the exception of 10 of these laws, four of which contain only minor exceptions,[88] and six others the statutory language of which might possibly be construed otherwise,[89] the prohibition is absolute.

Another wholesaler-retailer non-integration statute is found in the California law[90] which prohibits wholesalers of frames, lenses, optical supplies, optometric appliances or devices and kindred products from engaging in the retail business of filling prescriptions of physicians and surgeons for ophthalmic lenses and kindred products. To the writers' knowledge, this statute has not been tested in the courts.

Finally, it is interesting to note that in the meat-packing cases[91] already discussed, the general prohibitions of the Sherman Act were used not only to prohibit the combination of unrelated lines of groceries with that of meats, but also to prohibit such companies from engaging in the retailing of meats.[92] In the second *Swift* case,[93] the two companies, Swift and Armour, asked that the consent decree be modified

[84] IOWA CODE (1939) §6943.128.

[85] MINN. STAT. (Mason, Supp. 1940) §5887-18b (fuel, lumber, building material, gasoline and oils and grains); S. D. CODE (1939) §57.3403 (same as Minnesota plus dairy products, poultry, electric current, natural or artificial gas, and telephone service). See also Tex. Laws 1st Ex. Sess. 1935, c. 400, §5 (exempts those dealing exclusively in lumber and building materials).

[86] Compare this legislation directed at horizontal chain integration with the discussion, *infra*, of prohibitions on vertical chain integration contained in the Patman Bill to divorce chain retailing from manufacturing. See Stevens, *Chain Store Taxation* (1940) 33 Proc. Nat. Tax Ass'n 170 for criticism of the original Patman federal chain-store tax proposal for its failure to exempt accessory-selling as well as pure filling stations. Stevens clearly views such legislation as presenting the economic issue of the validity of penalization of horizontal integration.

[87] Ala., Ark., Calif., Colo., Conn., Fla., Ill., Ind., Iowa, Kan., Me., Mich., Minn., Miss., Mo., Mont., N. H., N. J., N. M., N. Y., N. D., Ohio, Ore., R. I., S. D., Tenn., Tex., Vt., Va., Wash., W. Va., Wyo.

[88] Ill., Ind., Mont., N. H., permitting retail sales at the wholesale premises only, or limiting the wholesaler to one retail license.

[89] Me., Mich., Miss., N. M., Ohio, Tenn. *E.g.* OHIO CODE ANN. (Baldwin's Throckmorton, 1940) §6-64-24: "No wholesaler shall have any interest in the business of any retail dealer."

[90] CALIF. BUS. & PROF. CODE (Deering, Supp. 1939) §2553.5.

[91] See notes 25 and 26, *supra*. [92] See note 24, *supra*.

[93] United States v. Swift & Co., *supra* note 25.

to permit not only the wholesaling of groceries, but also the operation of retail meat markets. Although the Supreme Court of the District of Columbia, in which the petition for such modification was filed, permitted modification to allow the wholesaling of groceries, a decision subsequently reversed by the United States Supreme Court,[94] it refused to permit the retail sale of meats, a refusal affirmed by the high Court.[95] As this Court said, "The one prohibition equally with the other was directed against abuse of power by the individual units after the monopoly was over. . . ."[96]

VERTICAL INTEGRATION OF PRODUCTION AND DISTRIBUTION

The legislative weapon has also been used to divorce production from distribution in certain fields by prohibiting the integration of the function of production with that of distribution. The greatest activity in this line is again to be found in the field of alcoholic beverages. No less than 36 states to some extent prohibit manufacturers of one or more types of such beverages from engaging in the retail sale thereof,[97] while 13 states also prohibit them from engaging in the wholesale business.[98] Twenty-two of the states which prohibit retailing by manufacturers make the prohibition an absolute one,[99] while of the remaining laws, five contain only minor exceptions, such as permitting the manufacturer to retail his own products from his manufacturing premises only,[100] and nine contain language which, although not as clear-cut as in the other 22 states, could be construed as prohibiting such integration.[101] Such a complete prohibition is but an extension of the provision of the Federal Alcohol Administration Act[102] prohibiting manufacturers from holding an interest in retail establishments if it has the effect of inducing the retailer to purchase the products of the vendor to the exclusion in whole or in part of competing products.[103] This limitation, which discloses the original purpose behind the enactment, is found in only one of the state laws prohibiting manufacturer ownership and control of retail establishments.[104]

[94] *Ibid.*

[95] *Ibid.*

[96] *Id.* at 117. For the reasons for this separation of functions, see the discussion of the *Swift* cases under product-integration, *supra.*

[97] The only states not enacting such a prohibition are: Ariz., Ga., Idaho, Ky., La., Mass., Nev., N. C., Okla., S. C., Utah, Wis. For an example of this type of prohibition see FLA. COMP. GEN. LAWS ANN. (Skillman, Supp. 1936) §4151(228): ". . . no license shall be issued to a manufacturer . . . as a vendor [retailer], nor shall any license be issued to a vendor as a manufacturer. . . ."

[98] Ala., Calif., Conn., Ind., Me., Mich., Neb., N. J., N. D., R. I., Tenn., Tex., Vt. *E.g.*, IND. STAT. ANN. (Burns, Supp. 1940) §12-515: "No person holding a manufacturer's . . . permit may own . . . any permit to wholesale alcoholic spirituous beverages. . . ."

[99] Ala., Ark., Calif., Colo., Conn., Del., Fla., Ind., Iowa, Minn., Mo., Neb., N. J., N. Y., N. D., Pa., S. D., Texas, Va., Wash., W. Va., Wyo.

[100] Ill., Md., Mont., N. H., Ore.

[101] Kan., Me., Mich., Miss., N. M., Ohio, R. I., Tenn., Vt. Such language usually reads: "No manufacturer . . . may have any interest in the business of any retail dealer." MISS. CODE ANN. (Supp. 1938) §2878.

[102] The Federal Alcohol Administration Act, 49 STAT. 977, 27 U. S. C. A. §§207-212 (1935).

[103] *Id.* §5(b)(1), (2); *id.* §205.

[104] N. M. Laws 1939, c. 236, §1405(b)(1), (2) prohibiting a producer from acquiring or holding any interest in any license with respect to the premises of a wholesale or retail liquor dealer for the purpose of inducing such dealer to purchase alcoholic beverages from such producer to the exclusion of others.

Although there is little direct judicial authority on the constitutionality of such prohibitions, it is probable, owing to the unique legal position of the liquor business, that the courts will support them. The judicial attitude taken is that[105]

> the liquor traffic is not a lawful business, except as authorized by express legislation of the State; that no one has the natural or inherent right to engage therein. . . . It is placed under the ban of law, and it is . . . therefore separated or removed from the natural rights, privileges and immunities of the citizen.

Furthermore, indirect judicial approval of such a prohibition has been expressed in a case[106] which interpreted the Maryland liquor laws as prohibiting a corporation operating more than one retail drugstore in Baltimore at the time of the law's enactment, from obtaining a renewal of licenses for stores transferred to that corporation after enactment of the statute, even though these stores had been licensed by the transferor. In the course of its opinion the Maryland court said:[107]

> Section 22, on transfer of licenses, in terms permits "any holder of a license" to . . . sell or assign his license and stock in trade. . . . The provision expresses no limitation upon the persons who may receive transfers; but it could not be contended that there are no limitations under the act. In sections 5(11), 28, and 33 there are elaborate provisions to prevent the holding or control of retail licenses by manufacturers or wholesalers, and section 22 would not be construed to furnish an easy escape by permitting the ownership or control by purchase. . . . Transfers would be permitted only to persons not denied a right to hold licenses.

Efforts to prevent ice cream retailers from engaging, by means of the counter-freezer, in the manufacture of ice cream have met with defeat in at least one jurisdiction through judicial condemnation,[108] and in at least four others through specific legislative recognition of the use of such freezers.[109] The restrictive efforts had taken the form of attempts to apply to such manufacturing the existing stringent sanitary legislation requiring the sterilization of equipment with live steam, the use of sloping cement floors with a central drain, and detailed pasteurization procedures.[110] In the Virginia case it was held that the operator of a drugstore counter-

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[105] State v. Parker Distilling Co., 236 Mo. 219, 255, 139 S. W. 453, 461 (1911). *Accord:* State v. Wipke, 345 Mo. 283, 133 S. W. (2d) 354 (1939); McCarroll v. Clyde Collins Liquors, 198 Ark. 896, 132 S. W. (2d) 19 (1939); Franklin Stores Co. v. Burnett, 120 N. J. L. 596, 1 A. (2d) 25 (1938). See also, State Board of Equalization v. Young's Market Co., 299 U. S. 59 (1936).

[106] Baltimore Retail Liquor Package Stores Ass'n, Inc. v. Kerngood, 171 Md. 426, 189 Atl. 209 (1937).

[107] *Id.* at 432, 189 Atl. at 211. See also, State v. Krawczak, 217 Wis. 593, 600, 259 N. W. 607, 609 (1935), in which the court said, concerning a provision limiting the number of retail beer licenses which any one person could hold, to two: "It is a matter of common knowledge that the purpose of limiting the number of Class B beer licenses to two was to prevent a brewer from establishing a chain of licensed places as was commonly done in pre-prohibition days, the management of which the brewer controlled and in which sales of beer were limited to the brewer's own product."

[108] Robertson v. Commonwealth, 168 Va. 752, 191 S. E. 773 (1937), interpreting VA. CODE ANN. (Supp. 1938) §1215 as inapplicable to counter freezing.

[109] MICH. STAT. ANN. (Henderson, 1936) §12.788; Miss. Laws 1940, c. 120, §105; MONT. REV. CODES (Anderson & Wertz, Supp. 1939) §2620.20(i); WIS. CODE (1939) §970.05.

[110] Typical of stringent sanitary regulations for the manufacture of ice cream are ILL. REV. STAT. (Smith-Hurd, 1939) c. 48, §§53-57; R. I. REV. GEN. LAWS (1938) c. 260, §§3, 4, 5. Quite similar to

freezer was not engaged in the manufacture of ice cream within the contemplation of the statute. In so holding, the court said:[111]

> The specifications for the contents of the various kinds of ice cream, for the pasteurization of the milk used, for the type of building in which the work is to be done, and for the handling, storage, and transportation of ice cream, all convince us that the framers of the statute had in mind operations of a much wider character than those performed by the defendant here.

A great deal of activity, both federal and state, against the integration of production and distribution has also been taking place recently in the motion picture field. The first law to divorce the exhibition of films from their production appeared on the statute books of North Dakota in 1937.[112] This law, repealed in 1939, made it unlawful for any motion picture theater to be operated in the state when owned, controlled, managed or operated, in whole or in part, by any producer or distributor of motion picture films or in which any producer or distributor had any interest, direct or indirect, legal or equitable, through stock ownership or otherwise. Violations of the statute were made subject to injunction or criminal penalties of a maximum fine of $10,000, imprisonment for one year, or both. Similar "divorcement" bills have been introduced in the current legislatures of Minnesota and Nebraska, and are now pending.[113]

National legislation with the same purpose was introduced in Congress on April 9, 1940. Although hearings were held and the bill reported out of committee, no final action was taken at that session of Congress.[114] It has, therefore, been reintroduced in the present session.[115] This federal bill in its prohibitory clause is couched in language almost identical to that of North Dakota. It makes it unlawful for any producer or distributor "engaged in commerce"[116] to own, operate or have any interest in, any motion picture theater in any state, territory or the District of Columbia. Furthermore, in the anti-trust suit in equity commenced by the Department of Justice in 1938 against the great theater-owning picture producing companies,[117] the prayer for relief included a request for "theater divorcement." However, the consent decree entered on November 20, 1940, between the government and the five theater-owning companies, provides for a three-year trial period during which

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the Virginia law construed in Robertson v. Commonwealth, *supra* note 108, these enactments are therefore susceptible to similar judicial interpretation.

[111] Robertson v. Commonwealth, *supra* note 108, at 756, 191 S. E. at 775.

[112] N. D. Laws 1937, c. 165, §§1-7, repealed by N. D. Laws 1939, c. 202.

[113] Minn. S. F. 69, 1941; Neb. L. B. 208, 1941.

[114] S. 3735, introduced by Senator Neely on April 9, 1940. Referred to Senate Committee on the Judiciary. Hearings before a sub-committee: April 22, May 16, 1940. No final action.

[115] Re-introduced as S. 185 on Jan. 6, 1941. Referred to same committee.

[116] "Engaged in commerce" is defined to include transactions whereby films produced in one state are shipped by the producer or a subsidiary or affiliated corporation to film laboratories or exchanges in other states, or sold, leased or licensed by the producer at the point of production to a distributor and so shipped to film laboratories or exchanges in other states, and in either case distributed by such exchanges to motion picture theaters. S. 3735, §2(6).

[117] U. S. v. Paramount *et al.* (D. N. Y., July 20, 1938).

the government may observe whether other provisions of the decree will make "divorcement" relief unnecessary.

A federal district court, prior to repeal of the North Dakota statute, sustained that law as a valid exercise of the police power of the state.[118] In doing so, it decided that the act was designed to promote the general welfare of the public by prohibiting practices which might reasonably be conceived as promotive of monopoly and restraints of trade. It made no difference, said the court, that the facts of the present case did not justify a finding that the plaintiffs, motion picture producers, had a monopoly in North Dakota, were threatening to obtain one, or had been guilty of any serious abuses with respect to competitors or to the public in North Dakota. There was[119]

> . . . evidence in the record which justifies an inference of suppression of local competition in states other than North Dakota by producers having affiliated theaters; and . . . of the existence of the power and temptation of such producers to engage in practices promotive of monopoly and restraint of trade.

In the opinion of the court,[120] the existence of such power

> when coupled with the opportunity and the temptation to use that power, is . . . a sufficient basis for legislative action to prevent the possibility of its exercise. This must certainly be so where there is, in addition, evidence of past aggressions.

Here again, as in the meat-packing cases, one finds the courts recognizing as sufficient justification for enforced non-integration, the existence of the power to engage in monopolistic practices which integration would give.

One other movement worthy of note, in the activity to divorce production from the retailing function, is found in the bill first introduced in Congress in 1937 by Mr. Patman[121] to divorce chain-retailing from manufacturing by preventing "manufacturers of products from offering for sale and selling the same at retail . . . where the effect of so . . . selling . . . at retail to consumers may be substantially to lessen competition between such manufacturer and his customers,[122] or tend to create a monopoly in such line of commerce or to injure, destroy or prevent competition by, a customer or customers of such manufacturer. . . ."[123] The bill would

[118] Paramount Pictures, Inc. v. Langer, *supra* note 10, remanded by the Supreme Court of the United States with directions to dismiss because repeal of the statute had rendered the cause moot. 306 U. S. 619 (1938).

[119] *Id.* at 900. See also Crescent Cotton Oil Co. v. Mississippi, *supra* note 10, which approved an outright prohibition upon the operation of both cottonseed oil mills and cotton gins by the same corporation on the ground, among others, that the legislation was designed to prevent practices promotive of monopoly.

[120] *Ibid.* The court here cites and quotes from the second *Swift & Co.* case, *supra* note 25, at 116: ". . . size carries with it an opportunity for abuse that is not to be ignored when the opportunity is proved to have been utilized in the past." Compare these attitudes with that of the Kansas court in holding the utility anti-merchandising law invalid. Capital Gas & Electric Co. v. Boynton, *supra* note 18.

[121] H. R. 4722, 75th Cong., 1st Sess. (1937) introduced Feb. 15, 1937. Referred to the House Committee on Interstate and Foreign Commerce. Hearings before a sub-committee: Dec. 1, 2, 3, 1937 and Jan. 4, 5, 6, 1938. No further action.

[122] "Customer of such manufacturer" is defined by §2 to include only a retail dealer who at any time already is established in the business of offering for sale and selling to consumers commodities produced or manufactured by such manufacturer.

[123] *Id.* §3.

make such activities an "unfair method of competition in commerce" within the meaning of Section 5 of the Federal Trade Commission Act, and would authorize the Commission to proceed against any manufacturer it had reason to believe was using such unfair methods. Possible spread of this idea to state legislative channels is suggested by the fact that a similar bill has been introduced in the present session of the California legislature.[124]

Clearly here the weapon of protective legislation would be wielded in favor of independent merchants as against the large chains. Integration of production and distribution would be prohibited not to all in a given line of distribution but only to those who have "integrated" in the sense of common ownership and control. But the opposing philosophies remain ever the same. A national association of oil wholesalers and distributors expressed itself in support of the Patman bill as follows:[125]

> This association favors the additional principle of severing the manufacturer from wholesaling as well as retailing. . . .
>
> The whole history of the integrated companies engaged in marketing has been a continuous series of unfair practices. . . .
>
> Today we have in the tire industry, I understand, a grand scrap between four, five, or six companies for the business. Evidently, eventually the time will come where there is going to be but one. I mean, *that is the trend of monopoly* and I am wondering why we could not say in advance that these things which tend to create a monopoly shall be stopped?

And in opposition the old, familiar arguments are used:[126]

> Finally . . . what of its constitutionality? . . . What becomes of the constitutional liberty of the manufacturer to select his own customers, in bona fide transactions not in restraint of trade? That right includes the right to sell direct to consumer if the manufacturer chooses . . . And wherein does this bill have any relation to the fostering and promotion of competition, if such be its object? It does not foster and promote competition, but prevents and freezes it. It means that once a manufacturer has sold to a retailer, he cannot thereafter sell to a consumer direct, in that locality, at the same or a lower price. . . . Instead of promoting competition, it would freeze business in the hands of the middleman. . . .

[124] Further federal agitation along similar lines is revealed in the recent introduction of a "divorcement" bill for petroleum. S. 170, H. R. 1402, 77th Cong., 1st Sess., Jan. 6, 1941.

[125] Statement of P. E. Hadlick, Secretary and Counsel, National Oil Marketers Ass'n, *Hearings before Sub-committee of the House Committee on Interstate and Foreign Commerce on H. R. 4722*, 75th Cong., 3d Sess. (1937) 67, 68, 71. See also United States v. Swift & Co., *supra* note 25; Paramount Pictures v. Langer, *supra* note 10; *cf.* Capital Gas & Electric Co. v. Boynton, *supra* note 18.

[126] Statement of Reynolds Robertson, representing the Warm Air Furnace Manufacturers, *Hearings*, *supra* note 125, at 93.

ECONOMIC IMPLICATIONS OF BUSINESS BOUNDARY LAWS

Corwin D. Edwards*

One of the characteristics of a system of free private enterprise is that private decision establishes the boundaries between administrative control and market bargaining. The relations of business enterprises to each other are determined primarily by a constant and flexible process of negotiation and bargaining which is given an occasional evanescent stability by a long-term contract. The internal organization of each enterprise is based not upon bargaining but upon structure. Materials and equipment are subject to a coordinated control, and even personal services, once the employment relation is established, are subject to continuous direction by the management. In spite of internal conflicts of interest, the institutions of ownership usually channel the activities of an enterprise toward its own greatest profit, whereas the broader organization of an industry and of the economic commonwealth is established by the interaction of frankly conflicting interests.

Generally speaking there are no limits to the shape and direction of an enterprise and no limits to its size other than those ultimate ones which may be established by the laws against monopoly. Those in control may produce any combination of commodities and services, however diverse, and may, as they choose, perform a single operation or the complete series of operations between raw material and consumer. There is room for an infinite diversity in the structure of different concerns, so that short-line producers and long-line producers, handicraft establishments and mechanized plants, single and multiple unit manufacturing companies, producers who buy and producers who make their raw material may exist side by side in the same industry. The grouping of products for joint production or distribution may be so diverse that there are no boundaries between one industry and the next except as they may be arbitrarily defined for some statistical purpose. In distribution the specialty shop and the department store, the independent unit and the corporate or voluntary chain, the consumers' cooperative and the manufacturers'

* A.B., 1920, B.J., 1921, University of Missouri; B.Litt., 1924, Oxford University; Ph.D., 1928, Cornell University. Economic Consultant, Antitrust Division, Department of Justice. Formerly, Assistant Chief Economist, Economic Advisor, Federal Trade Commission; Technical Director, Consumers Advisory Board, NRA; Associate Professor of Economics, New York University. Author, Final Report on NRA (Division of Industrial Economics, 1937). Co-author, with J. B. S. Hardman, ed., American Labor Dynamics (1928); with W. E. Atkins, ed., Economic Behavior (1931); with W. L. Thorp, ed., Economic Problems in a Changing World (1939). Contributor to periodicals.

outlet may vie with each other in the same city block and may range in size from a glassed-in alcove to a many-storied building.

As the arts of management have been elaborated, many concerns have developed corporate structures within which economic processes are related neither by the arms-length bargaining of the market nor by the fiat of a single management, but by a loose managerial alliance, intermediate in character. Equipment companies, management companies, wholly-owned subsidiaries for the manufacture of by-products, marketing subsidiaries, semi-autonomous product divisions, and the like may be viewed for some purposes as separate enterprises and for others as parts of a tight community of interest. For the most part such extrusions of managerial control are likewise unrestrained by authority. The single concern may exist side by side with a bewildering variety of holding company structures.

Insofar as the over-all structural boundaries of business enterprise are determined by private initiative and the arbitrament of market competition, the test for the success of any union of economic processes under any kind of managerial structure is merely its ability to survive. If it appears to offer no advantage to business men, present or prospective, it will not be created. If it cannot resist attacks by other types of enterprise, it will be destroyed. Business types will endure and attain dominance or will disappear and be superseded as an incident of market competition in the same way that biological species undergo an evolutionary selection through their efforts to feed and reproduce.

Business groups which feel themselves threatened in the conflict between different types of business structure are beginning to turn to public authority for aid, and as it becomes apparent that the boundaries of an enterprise may be partially determined by law an increasing number of economic groups undertake a political competition for laws favoring their own type of structure or handicapping some rival type. That every such bill has the backing of one or more economic groups may be taken for granted. The Department of Justice has had occasion to point out in legal proceedings the effort made by certain ice cream manufacturers to establish sanitary requirements which would make it practically impossible for a drug store to manufacture its own ice cream in counter freezers. A bill is now being considered in the California legislature which seeks to limit the activities of chain stores by providing that no enterprise which owns more than two retail establishments may engage in manufacturing. This bill has the backing of certain groups of independent retailers who would like to make it impossible for chains to sell private brands which are not subject to the price control imposed by other statutes; and likewise the backing of some manufacturers who believe they could sell a larger volume with a greater bargaining power if their chain-store customers were deprived of the alternative opportunity to make the goods themselves.

Unfortunately the mere fact that a legislative proposal is intended to advance the competitive interest of some private group is insufficient to discredit the proposal or to indicate its relation to the public interest. If the fighting power of a business

enterprise were an adequate measure of its efficiency as a source of goods and services, free competition in the determination of business boundaries might be thought undoubtedly desirable. But to a generation which sees no necessary parallel between pecuniary results and economic efficiency, the matter is not so simple. A concern may be strong because it has achieved great bargaining power or because it has reserves which enable it to survive financial shocks that would destroy its rivals. An efficient concern may be weak because it lacks the money to weather a temporary emergency or because it is not armored against an unfair attack. In business, as in international relations, the way of life which makes for security in defense and for power in attack may be sharply different from that which the community would like to encourage.

Since the problems raised by size and corporate structure are dealt with elsewhere in this series of articles,[1] the issues as to the boundaries of business enterprise which are to be discussed herein will be limited to those involved in selling more than one product or engaging in more than one of the successive stages of production and distribution. Within this field certain outstanding problems may be indicated and illustrated, but the available information is not yet such as to permit a comprehensive account of the extent and relative importance of each problem.[2]

A preliminary distinction must be made between restrictions upon the boundary of an enterprise which express the public authority's desire to restrain trade and restrictions which have other purposes. In the distribution of alcoholic beverages some states forbid the producer to engage in wholesaling and a great many states forbid him to engage in retailing. The underlying theory of such legislation is presumably derived from the widespread belief that the sale of alcoholic liquor is inherently dangerous and that much is to be gained by a close control over the conditions of sale and a restriction upon the quantity sold. Prior to national prohibition, the manufacturers' control over saloons was regarded as partly responsible for efforts to sell liquor in quantities which encouraged drunkenness and conditions of vice and disorder that flouted the wishes of a large part of a community. In some jurisdictions the effort to make alcoholic beverages available without unduly promoting their sale has resulted in a system of state liquor stores intended to destroy the profit incentive in the retail liquor trade. The state laws which exclude the manufacturer from distribution presumably express a milder form of intention to limit the effort to build up a large volume of retail business. They prevent a competitive establishment of saloon outlets similar to the competitive establishment of filling stations which at times has been so conspicuous in the petroleum industry.

Legislation of this kind is obviously inapplicable to the great majority of indus-

[1] See Wolff, *Monopolistic Competition in Distribution;* Feldman, *Legislative Opposition to Chain Stores and Its Minimization,* both *infra* this issue.

[2] Cook, *Legislative Restrictions on Marketing Integration, supra* this issue, measures the field and its subdivisions quantitatively.

tries in which the community accepts the desirability of a larger output and is willing to obtain this output through the ordinary stimulus of the profit motive.

The most obvious issue which is involved in most attempts to enlarge a business by undertaking new types of activities is that of the power which may be exercised by the combination. There are several important kinds and degrees of such power.

When a concern which sells a considerable number of different products has obtained a strong bargaining position upon any one of these products, it is likely to be able to extend its bargaining power to cover the other products as well. The control over the product from which power is derived may be strong or weak; it may be due to a patent, to an unlawful monopoly, to the prestige of a well-advertised brand, or to peculiar qualities in the product itself. Such variations may affect both the number of the customers who find it necessary to buy this product and the degree to which each of them can be coerced. But, in any case, the seller has an opportunity to make his sale of the desired product conditional upon the customer's purchase of other commodities from him rather than from his rivals. By thus forcing his full line into the market, the seller handicaps any other seller who is unable to exercise a similar pressure. If the extent of the seller's power is not sufficient to support an arbitrary requirement that he receive all his customer's trade, inducements may be offered to persuade the customer. Special services and sales helps may be given to the full-line customer but not to others. Discounts may be so arranged that customers who buy less than the full line must pay higher prices. Special offers of the desired products packaged with some of the undesired ones may be advertised to the public at attractive prices. In some cases the exclusion of rival products from the market may be as effective as though purchase of the full line had been flatly required. Other cases may show a reduced effectiveness, to the point at which it is problematical whether the seller obtains any advantage.

The power to win trade by such requirements is greatest when there is no particular reason why the buyer should make his purchases elsewhere. Under such circumstances the attractiveness of the desired product is not likely to be lessened by the restrictions upon its purchase and it probably can be sold at a price as high as though no conditions were attached to the sale. But even if the seller must sacrifice a part of his power to charge a high price for his popular product, he may be richly rewarded by a progressive enlargement of the number of commodities over which he has substantial control. Problems of this kind are so familiar in the administration of the antitrust laws that the public policy applicable to them was crystallized as long ago as 1914 in Section 3 of the Clayton Act, which forbids sales of goods in which either the sale or the price is conditional upon an agreement not to buy the products of competitors. In practice, any arrangement which has the practical effect of preventing purchases from competitors is prohibited by this section. Moreover, where such practices are effective they are likely to be regarded as attempts to create a monopoly and therefore as violations of the Sherman Act. The packers' consent decree, which forbids the great meat packers from manufacturing

or handling a large number of food products not directly connected with the meat-packing business, is an illustration of the use of the Sherman Act to break up an extension of market control over a longer line of products.

The sale of a variety of products sometimes enlarges the marketing strength of the producer merely because of the number of products sold, even though no one of these commodities may be a source of any special power. Since the customer incurs expense and inconvenience in finding sources of supply and in bargaining with them, he may prefer to obtain his requirements, so far as possible, from a single source. It is notorious, for example, that department stores often have higher average mark-ups than more specialized retail outlets and yet have a more rapid turnover, largely due to the fact that many shoppers find it convenient to remain under one roof. Similar considerations may influence commercial buyers. Moreover, the seller merchandising a large number of products may be able to offer services which could not be readily supplied by a specialized concern. When he ships, he may send carload quantities to communities too small to take a carload of one or two products. With his warehousing and sales expense spread over more products, he may be able to undertake a more intensive sales campaign. The department store may be able to afford a free parking lot; the manufacturer may supply the services of a demonstrator. The mere fact that income is derived from many commodities which are subject to different kinds of demand and different seasonal peaks and which are affected by the different prices for different raw materials may in itself reduce the over-all fluctuations of the enterprise's prosperity. Insofar as these commodities are derived from the same source or are sold to the same customers, the concern handling them may attain an importance for those with whom it deals which cannot be seriously diminished by its price policy or its service in selling any one item. Thus it may attain a degree of freedom from competitive comparison by the mere diversity of its sales.

A variety of products likewise affords the enterprise great attacking power in the competitive sale of any part of its products. Being independent of the revenue from a particular product or product line, the multiple-line producer is free to cut prices much further and continue his cuts much longer than a concern which derives its whole revenue from those products upon which the cut takes place. Therefore, the producer of a limited line of products is likely to be at his mercy. A department store, for example, can adopt a low-price policy upon books with a hope that the general revenue of the store will be increased by customers who are attracted by the book department but also spend money in other departments. The smaller bookseller, however, may find it difficult to match the department store's low prices. This competition between unspecialized and specialized sellers should be sharply distinguished from so-called loss leader selling; for in the mere use of loss leaders the products reduced in price represent only a small part of the trade of any one of the competitors and the price reduction is therefore of much less consequence. The price cutting which a concern selling many lines can undertake against a con-

cern selling a few is similar to that which can be undertaken by a nation-wide concern against a local one. It covers the victim's whole market, but is of minor importance to the aggressor.

Very frequently, however, the low prices which may be charged upon certain goods in a long line may be developed without malice against any competitor, as an expression of some of the opportunities and economies involved in extending the business. A going concern can often produce or distribute additional products at a relatively low cost. One factor which encouraged the meat packers to go into the grocery business was the fact that they had storage facilities, shipping facilities, and a sales organization well adapted to handle other food products than meat and that consequently they could distribute these products with less additional expense than they would have incurred in building up a separate grocery enterprise. In many lines of manufacture there are scrap or waste products which the management learns to adapt to some useful purpose but which might not be produced if the basic manufacturing processes were not already being carried on for the sake of other commodities. In all such cases, whether the economies arise in production or distribution, the essential point is the fact that since some expenses have already been incurred the additional sales are profitable even if they do not carry their full share of those expenses. Commodities sold under such conditions are always by-products in the sense that they need not cover a proportionate share of the total costs.

A problem arises wherever one concern's by-product is the basic product of a competing concern. Drug stores can outdo electric appliance shops in the sale of simple appliances. Grocery stores can outdo drug stores in the sale of packaged cosmetics or drugs. The convenience outlets for candy and tobacco may often charge prices so low that they would be ruinous to the confectioner or tobacconist. A small-town newspaper may do job printing at rates which cannot be matched by an independent printer. The victims usually insist that low prices thus established constitute unfair competition and are based upon an untenable allocation of costs. The producers of by-products point to their ability to render the same service indefinitely at the same low prices and argue that the public gains by every use of idle facilities and waste materials. When the output of the by-product can become large enough to supply the market, the independent producer of the commodity is probably doomed, for the grouping of product and by-product together in the same enterprise will become typical; but when the market must rely in part upon the independent producer, there may be a long period during which his solvency is intermittently threatened at such times as the total demand is low enough to induce the seller of the by-product to quote low prices.

In some cases strategic advantage lies with the business which handles only a few lines rather than many. This is typically true when some products move more rapidly or require less expense than others with which they have been traditionally associated. A drug store, for example, carries popular lines of packaged drugs which have a rapid sale, less popular lines which move slowly, and various prescrip-

tion drugs which may be asked for on rare occasions. The time and skill used in filling a prescription are much greater than in selling a packaged product. In the last few years large cities have developed stores which carry only the fast-moving packaged drug items and therefore can do business at a much lower cost than the ordinary drug store. A similar concentration upon the more profitable business is apparent in many food supermarkets.

The development of such low-priced specialty businesses is typically accompanied by insistence on the part of the older enterprises that it is unfair to take the cream of the market and expect someone else to supply the skimmed milk. They argue that the less profitable parts of their activity must be preserved in the public interest and cannot be preserved alone. The defenders of the new concerns which have a narrow scope emphasize not only the importance of business freedom but the desirability of distributing any product as cheaply as possible. From the public point of view, the issue may be defined as a controversy over social cost accounting. Customers for fast-moving lines were formerly asked to subsidize other products. The new way of doing business gives them the opportunity to avoid this subsidy, and will result either in disappearance of the unprofitable products and services, in higher prices upon them, or in a subsidy derived from some new source. The period of readjustment is likely to prove painful to concerns which are already established, but no more so than many of the other changes in the location of the boundaries of business enterprise.

In the union of successive stages of manufacture and distribution there may be problems of competition among concerns of different scope similar to those described above, but such integration also involves special problems not raised by an extension of the line of products handled. The most obvious of these is the squeezing of competitors by a concern to which these competitors must look for their supplies. For many years the Aluminum Company has produced all the aluminum ingot made in the United States and has also been a substantial fabricator of this ingot. Independent fabricators selling in competition with the Aluminum Company have found it necessary to pay the company's price for ingot and to charge prices no higher than the company's for their finished product. Since it was a matter of indifference to the integrated concern whether its profits were derived from ingot or from fabricated products, it was easy to keep the price of ingot high and thus reduce the fabricator's margin. The Bausch Machine Tool Company brought suit on the ground that this device had been used to make the independent manufacture of duralumin unprofitable and thus to extend the Aluminum Company's business in the manufactured products.[3] Similar charges have been made against the large steel makers, the large copper companies, and various other integrated enterprises. Except where the integrated concern has a substantial control of supply, the availability of materials from other sources makes such a squeeze impossible.

[3] Bausch Machine Tool Co. v. Aluminum Co., 72 F. (2d) 236 (C. C. A. 2d, 1934), *cert. denied*, 293 U. S. 589 (1934).

By discrimination in favor of its own distributive outlets an integrated system of manufacture and distribution may decrease the ability of an independent distributor to serve his customers. A recent antitrust proceeding against large motion picture producers and distributors illustrates this possibility. The government charged that theatres which are affiliated with large producers and some chains of theatres not so affiliated were given first choice of pictures and earlier exhibition dates for the pictures they chose. The advantage of such chains was increased by granting them permission to select the features they would exhibit and also to select other features for options or rental contracts which would prevent the first-run exhibition of these features by independents. Independent theatres were required to accept all feature pictures offered by the producer in order to get any of them and were likewise required to accept the producer's short subjects to fill out the programs. Independents were also placed at a disadvantage by high film rentals, discrimination in various fees and services, and requirements that their admission charges for second-run pictures be unduly high.

An experimental decree was entered last fall which protects the independent distributor from the requirement that he accept newsreels and other short subjects; increases his ability to choose among feature pictures by forbidding the lease of such pictures in blocks of more than five; and establishes an arbitration system to deal with the many complicated problems involved in timing the release of pictures to competing theatres. During a three-year trial period, the decree provides, the defendants will not enter upon a general program of expanding their theatre holdings, and the government will not take further steps to divorce production and distribution of motion pictures from exhibition of them. Whether or not the limited provisions of the decree will be sufficient to enable independent theatres to compete effectively with affiliates of the producers will appear from experience under the decree.

The attack upon manufacture by chain stores which is now getting under way raises a different issue. Organized groups of independent merchants, particularly in the food field, have been attempting for years to prevent chain stores from underselling them at retail. One stage in this campaign was support for an amendment of the Clayton Act which reduced the opportunity for the chain buyer to purchase goods from the same manufacturer more cheaply than could the independent. Another step was support for state legislation designed to permit the manufacturer of identified goods to fix resale prices which everyone must observe. Although this legislation was of primary interest in the drug trade, in which it hampered price-cutting independents and department stores rather than chains, it was used to some extent in the food industries to control chain-store prices. A third step was support for legislation which forbade sale at retail below cost. However, the food chains have partially escaped the impact of such laws by manufacturing their own products, thus avoiding any issue of price discrimination, and transferring these products to their retail establishments on terms which make possible a low

retail price. A successful effort to force them out of manufacturing would eliminate one of the remaining means by which they continue to follow their own price policies.

Any general refusal to allow a user or retailer of a product to engage in manufacturing would have the effect in some cases of weakening resistance to the monopoly power of an organized selling group. One reason that industrial concerns, mail-order houses, department stores, and chains can often buy cheaply is the fact that if the price is higher than a reasonable cost of manufacture the purchaser may be in a position to produce the article for himself. Ford has been particularly active in producing a portion of each important article he buys in order to have a check upon the reasonableness of the prices he pays and a nucleus for the expansion of his own output if he cannot buy advantageously.

The joint management of successive processes in production and distribution sometimes involves a special opportunity to be more efficient. The dovetailing of processes in the manufacture of Ford automobiles, for example, has been carried so far that, by previous standards, inventories are negligible. In steel manufacture the close juxtaposition of successive processes often enables a large concern to eliminate in part the cooling and reheating of steel. It also enables an integrated concern to adapt the composition of alloys very closely to the requirements of subsequent metallurgical processes and to experiment freely with both the metal and the means of working it. In so far as a concern produces its own supplies, it is relieved of much of the market uncertainty and the sales activity which are inherent in bargaining relations between independent enterprises.

However, some of the most obvious of the efficiencies developed by vertical integration may be subject to a serious discount for the disturbances which they set up elsewhere in the economic system. The efficiency of the large automobile plant is achieved by creating inefficiencies in the plants which supply it. Deliveries of upholstery material, for example, are ordered, suspended, delayed, cancelled, and reordered as suits the automobile company, often with little regard for the production and inventory cost of the upholstery manufacturer. The inventories of independent sources of supply take the place of inventories in the automobile plant, and the intermittent activity of these independents becomes the basis upon which the automobile producer obtains flexibility without waste.

Moreover, a vertically integrated concern loses some opportunities to profit by the misfortunes of others. Though it need pay no unnecessary profits to its controlled sources of supply, it must meet their costs, whereas at times the independent buyer may purchase his supplies at distress prices. Though no exorbitant mark-ups need to be allowed to controlled outlets, the concern which does its own distributing loses the opportunity to use the many distributive outlets which spend more than their mark-up in distribution. It does not get the benefit of the market coverage which can be afforded by a retailing system in which there are often too many stores too close together to make profits.

The foregoing summary of some of the more obvious problems as to the boundary of an enterprise is intended to illustrate the point that public intervention is sometimes desirable, but that it may easily do more harm than good. Both multiple lines and vertical integration may be used to promote efficiency as well as to extend or consolidate excessive bargaining power. No crude standard which accepts one type of structure and rejects another would be adequate to express the differences between cases.

Intervention by law may take several different forms. It may be based upon the broad principles of antitrust legislation and may ask the courts to decide the applicability of these principles, case by case. It may seek to outlaw particular types of structural relationship, like manufacturing by chain stores, or particular uses of power, like full-line forcing, in statutes applicable to all industry. It may be specifically directed to the problem raised in a particular industry, as are most of the statutes discussed in the immediately preceding article.

The advantage of dealing with such problems case by case under the antitrust laws lies in the fact that the results of a particular expansion of activity in a particular industry become the basis for action. Where no problem of monopoly or of unreasonable restriction of trade has arisen, a business may be left free to attain whatever private and public advantages are associated with the handling of more lines of goods or with a more complete vertical integration. Yet the public authority may act to terminate a program of expansion designed to drive out independents, whether by squeezing their operating margins, by predatory price cutting upon the products important to them, or by any other device. The fact that federal enforcement agencies have been given so little staff that until the last two or three years they could make no serious attempt to enforce the antitrust laws has prevented the efficacy of this procedure from being demonstrated by experience. Even now the funds for enforcing the Sherman Act are probably not more than one fourth as large as they must be if the Antitrust Division is to do a systematic job. The lack of antitrust laws in some states and of adequate machinery for administering these laws in most states has prevented the use of similar technique in dealing with horizontal and vertical combinations of economic processes in intrastate commerce. Nevertheless, the antitrust procedure remains the most flexible means of distinguishing between public and private interests in this field.

The difficulty in outlawing particular forms of structure or of behavior lies in the fact that the statute may prevent much which is harmless or even beneficial. Whether or not manufacture by chain stores is a problem which calls for public action, it is clear that some manufacturers who maintain retail outlets and some retailers who make a part of their own supplies are not thereby causing harm. Indeed, the increase of efficiency and avoidance of exploitation which may sometimes go with vertical integration has been illustrated in the foregoing discussion. There is a distinct possibility that the large distributors at whom the proposed statute is aimed might be able to protect themselves by purchasing the entire output of a

normally independent producer, whereas smaller distributors would be more effectively prevented from acquiring a control over production.

Similarly, a statute which strikes at full-line forcing raises abundant problems as to borderline practices which have only a limited effect upon competitors but may contribute to low-cost distribution by the concern adopting the practice. The federal statute is designed to deal with the more flagrant restraints rather than with these marginal cases. It is doubtful whether there have been many successful proceedings under Section 3 of the Clayton Act where the situation did not also involve a violation of the Sherman Act.

As to the statutes setting up restrictions in a single industry which are described in Miss Cook's article, the resort to political weapons by private competitors is much clearer to the outside observer than is the public interest which is supposed to underly each such statute. The attack upon the soda fountain lunch is evident in the laws which forbid sale of food in rooms where other commodities are sold. There is obvious question whether the mere presence or absence of other commodities in a room is a significant guide as to whether the vendor has met the reasonable needs of sanitation. The attack upon the sale of appliances by public utilities obviously reflects the interest of independent merchants who are afraid of the marketing advantages enjoyed by utility companies. Where regulation of such sales consists merely in a requirement that the utility operations of the concern be kept separate from its other activities, the statute is obviously useful in preventing confusion in public utility control. But where an attempt is made to handicap or prevent the sale of appliances by utility companies, the public problem involved is often no greater than in many other unregulated instances in which one or more concerns obtain an advantage in a line of business incidental to their principal acitivities.

There is no need to multiply illustrations. At best, legislation which proceeds industry by industry invites the maximum amount of pressure from organized industry groups and creates the maximum difficulty for legislators in maintaining consistent standards of public interest without special favors for particular groups. Undue power acquired by extending the boundaries of an enterprise to cover additional activities is best dealt with, like other forms of undue competitive power, by a statute aimed at the objectionable results rather than at the means and applicable to the entire field of competitive industry rather than to a special group.

MONOPOLISTIC COMPETITION IN DISTRIBUTION

Reinhold P. Wolff*

Monopoly Redefined

Modern economics defines our present price structure as a synthetic product in which economic elements of both competition and monopoly have been blended.[1] Although the nature and effects of monopolistic competition in production have attracted wide interest among economists, lawyers, and governmental agencies, the field has been little explored as far as the distributive trades are concerned.

While in production and transportation the octopus of monopoly was being scientifically dissected and its parts analyzed, the analysts lost cognizance of the original goal of their analysis. They came to associate the evidence of the phenomenon with the phenomenon itself, price fixing with monopoly. They forgot that the whole theory of competition is essentially based on the assumption of a balance between production and consumption which should be obtained through the medium of a free price, and that this very balance, not free price, constitutes its essence. Particularly have the courts, which are required to cast economic theory into the mould of a legal formalism, failed to segregate the paraphernalia of monopoly from this essential maintenance of balance. They have failed to recognize big business as the largest threat to the balance of competitive forces.

The courts and many students of economics also frequently overlook some distinct features which give to operation of monopoly in the distributive trades a different aspect from what has been observed in manufacturing industries. Unlike his manufacturing counterpart, the large-scale dealer is more often both a monopolistic seller and buyer. The distributor, as the middleman between a large number of producers and a still larger number of consumers, holds a key position in the mechanism which determines the price to the ultimate consumer. To the proper balance of the system it is as important that competitive buying prevails as it is that there are rival sellers. If there is a monopolistic buyer or "monopsonist," as science calls him, the balance is disturbed.[2] A surplus profit occurs for the buyer, which has been called "consumer's surplus," that is comparable to the monopoly

* Ph.D., 1920, University of Freiburg. Former member of the Bar of Berlin. Assistant Professor of Economics at the University of Miami. Author of various writings on cartels, pricing, and marketing.
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[1] Chamberlin, The Theory of Monopolistic Competition (1933); Robinson, The Economics of Imperfect Competition (1932, repr. ed. 1938).

[2] The theory of monopolistic buying is ably discussed by Robinson, *loc. cit. supra* note 1, to whom we also owe a development of the idea of the "consumer's surplus."

profit harvested by the monopolistic seller. This profit exacted by the monopolistic buyer tends to prevent the allocation of productive resources to the consumptive use of largest marginal utility, a goal which is as important to society as low consumer price. This connection has frequently been misunderstood by economic analysts who are inclined to identify the public interest with the interest of the consumer in low price. As a consequence the public attitude toward monopolistic competition has generated inconsistent and non-uniform policies productive of serious impediments to efficient marketing.

The flow of goods from the producer to the consumer is comparable to a stream in which currents of unequal strength mingle. If barriers are erected to the free flow of the river, impediments are created which may retard the flow of some currents while accelerating others. Monopolistic competition in distributive trades may be compared to a river in which such wilful impediments have been erected. The obstacles tend to retard the free flow of some goods but they may also have the opposite effect of spurring others, of regulating and equalizing the stream of commerce. Imperfect competition, therefore, cannot be looked upon as an entirely anti-social force; some of the trade barriers to be found in distribution will have to be recognized as beneficial to marketing.

CONCENTRATION IN THE DISTRIBUTIVE TRADES

Only during the last thirty years has concentration of enterprise appeared in distributive trades. In its extent it continues to lag behind similar developments in the production and transportation industries.[3] Various reasons account for the preservation of small businesses in wholesaling and retailing. By their very nature, distributive trades, especially retailing, are conducted on a small scale. The individual transaction deals with small units of merchandise. At the retailing end, it involves close personal contact with the customer and implies the features of conservative trading methods that go with small business. In addition, there is evident lack of some factors that have created large-scale operators in other industries. There are not the requirements of large capital; there are few possibilities of achieving market control by patents. Interlocking directorates are less numerous, and control of supply conditions harder to achieve.

Nevertheless the tides of capitalistic concentration are beginning to engulf certain parts of the distributive industries. In the trend toward larger retail and wholesale units, the impetus comes from both the producing and the distributive side. Packaging and branding of manufactured articles have contributed greatly to attempts on the part of manufacturers to control retail outlets and to integrate retail operations. Skilled merchandisers among the dealers have developed methods of large-scale buying and selling. Urban growth has concentrated demand on shipping

[3] TWENTIETH CENTURY FUND, BIG BUSINESS, ITS GROWTH AND ITS PLACE (1937) 47, 48 gives a rather vague idea of wholesale and retail concentration. BERLE AND MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY (1933) c. 3 touches on the subject. BURNS, THE DECLINE OF COMPETITION (1936) does not emphasize the concentration that has occurred in distributive trades.

centers of the large cities. The motorization of transportation, the improvement of highways, the progress in refrigeration and in communications have connected formerly separated markets and facilitated their control by centralized selling and buying.

In many respects the large-scale distributor is superior to the small-scale operator. Merchandising efficiency is rare and places a premium on the effectively managed outlet. Larger capital resources allow impersonal sales promotion and advertising. Larger operators are better disciplined to deal with organized selling groups, and their superior economic power allows buying at lower cost. Experience also points to the fact that organized labor cooperates more freely with organized business than with the small establishment, and price fixing often goes hand in hand with unionized wages.

Thirty years ago the American retail business was divided into small parcels of more than a million store owners, none of them controlling any sizable portion of the market. At present, roughly one-fifth of the forty billion retail volume is dominated by some twenty-five large corporations.[4] Sixteen of these corporations are engaged in retailing and exercise direct control over approximately ten percent of the retail volume. Another ten percent of the retail business is less directly controlled by the three leading automobile manufacturers and by the five large integrated oil companies. The form under which this latter control appears is partly that of direct ownership, partly agency contracts, local franchises, and store leases with so-called independent retailers. Around this cluster of highly concentrated economic control is spread a fringe of medium- and small-size retailers who still number more than a million.

The department store represents the earliest development of large-scale business in American retailing. This type now represents only about one-fourth of one percent of all retail institutions, but accounts for about nine percent of all retail store sales. Quite a considerable number of department stores have sales of one hundred million dollars in a single year and not a few have sales between ten and one hundred million dollars. Many department stores are operated by chains or combined in ownership groups. One such group, The Allied Stores Corporation, operates twenty-nine large stores in sixteen states. Most outstanding as a group with relatively small but numerous units is the J. C. Penny Company which operates more than fifteen hundred stores and accounts for almost three hundred million dollars of annual sales.

After the department store, the mail-order house made history in American retailing. The two largest organizations of this type, Sears Roebuck & Co., and Montgomery Ward & Co., had grown into big business enterprises long before the first World War. When the development of motor transportation deprived the mail-order house of many of the advantages of its particular type of operation, each of

[4] See (1938) 2 TRADE REG. REV. No. 4. Also BECKMAN AND NOLEN, THE CHAIN STORE PROBLEM (1938); *Retail Distribution*, in CENSUS OF DISTRIBUTION (U. S. Bureau of the Census, 1935); Federal Trade Commission, *Chain Store Reports*.

these units transformed itself into a combined mail-order and chain department store organization. The tremendous importance of these two store systems, both on the buying and on the selling side of the market, is best illustrated by the fact that their combined sales volume of about a billion dollars accounts for more than two percent of all retail sales of the country.

The chain store has outgrown both the department store and the mail-order house in importance as a distributive agent. The census figures of 1935 revealed 22.8 percent of chain stores in total retail distribution. Not all chains, however, constitute big business, and the great number of medium-sized and small chains account for a considerable proportion of this total.

Corporate chain stores are most important in the price variety field where they command about nine-tenths of all sales. In this field the four largest corporate chains control about 73 percent of the total retail volume. They have a considerable share of the shoe store and the automotive accessory field and of grocery and drug distribution, but play a minor role in such fields as hardware, dry goods, and restaurant business. In the food retail trade, the corporate chains have grown by leaps and bounds. Five large chains control roughly two billions of sales or 20 percent of all food retail business, which is twice the volume of the 300,000 independent stores having individually less than $10,000 annual sales. In the department store and apparel field three large corporations do 15 percent of the total distribution of this class. The two large mail-order chains account for roughly a billion dollars of sales. A large shoe chain controls 10 percent of all men's shoes and four large chain systems do about 15 percent of the total shoe volume, the remainder of which is divided among 19,000 stores.[5]

Of more recent date is the development of the supermarket, which has grown into an important factor in the distribution of food and which is also gradually finding entrance in the drug and variety field.[6] Ten years ago there were not many more than two hundred supermarkets in the entire United States. At present their number is in the neighborhood of 5,000. Their volume of business, on the average $300,000 annually, outranks by far the orthodox grocery store but would not justify classification as large-scale business, were it not for the fact that many systems are multiple unit organizations. Although only one organization with fifty-nine markets and $25,000,000 annual sales has offered its stock in the investment market, the large corporate food chains have entered the supermarket field and have amalgamated some of their neighborhood units into larger markets. However, the majority of supermarkets are still operated by the independents.

VERTICAL INTEGRATION: MANUFACTURERS' CONTROLS

Hand in hand with the growth of large-scale business in the horizontal direction there has also occurred what may be called the vertical integration of distributive

[5] See Wolff, *The Chains Adjust Themselves to State Taxation* (Oct. 1939) 47 DUN'S REV. 20, 22.

[6] See Wolff, *The Rise of the Super Market and Some Marketing Consequences* (Sept. 1940) 48 DUN'S REV. 8 *et seq.*

trades. Large-scale manufacturers have sought control over distributive outlets; large-scale distributors, backward integration with producing establishments. Elements of monopolistic competition have been both the cause and the consequence of such concentration.

The reasons for which manufacturers have attempted to control distributive trades, to restrict entrance into such trades, and to regulate competition among retailers and wholesalers, are numerous. Foremost has been the desire to divert the price pressure to which producers are exposed if cut-throat competition prevails among dealers.[7]

Where a manufacturer advertises his product directly to the consumer, as in the drug and food lines, or in gasoline and rubber tires, control over distributive trades is frequently attempted in order to insulate a manufacturer's profit from the shock that it may receive from more efficiently distributed rival products. Especially do manufacturers who distribute via jobbers and independent retailers thus insure their sales volume against competition from products which are distributed direct to chain stores or supermarkets.

Where producers operate under high fixed costs, the maintenance of a steady demand may be expedient, and the control of distributive channels mandatory. The manufacturer's endeavors will here be directed rather toward the maintenance of recurrent dealer demand than toward an extraordinarily large volume of business, a purpose that is best accomplished by a limitation of the number of distributors.

Recently imperfections of the market have resulted from manufacturers' attempts to check the progress of dealer brands. Such private brands for wholesalers, mail-order houses, department stores, cooperative groups, and supermarkets have become a large threat to the national brand. They are frequently packed by manufacturers dependent or even indirectly owned by dealers. Vertical integration by manufacturers stands here against vertical control by dealers, a fact which demonstrates again the synchronization of competition and monopoly.

The means of manufacturers' control over distributive markets vary as between trades and manufacturers of varying size and strength. They range all the way from loose contractual relations to complete integration of distributive outlets. They embrace both the wholesale and the retail trade. We find them in local selling and in national distribution as well. The most intimate control a producer is able to exercise over the channels of distribution is the virtual absorption of all retail outlets.[8] Such direct distribution to consumers is, however, very infrequent. Only 2.4 percent of all manufactured articles are directly routed to the consumer buyer.[9] The practice is important in bread markets and for certain household articles. A far-reaching attempt to integrate retail outlets has also been undertaken by oil refiners but is now being abandoned by most operators.

[7] See GRETHER, PRICE CONTROL UNDER FAIR TRADE LEGISLATION (1939) c. 10.

[8] The nature and effect of vertical integration are described in BURNS, *op. cit. supra* note 3, at 418 *et seq.*

[9] *Distribution of Manufacturer's Sales*, in CENSUS OF BUSINESS: 1935 (U. S. Dept. Com., 1937).

More successful have manufacturers been in integrating wholesale activities. Especially since the appearance of chain stores, producers have undertaken nationwide distribution through their own wholesale establishments of such products as food, drugs, hardware, liquor, radios, automobiles, automobile tires, and office equipment. The manufacturer maintains either a sales office or a warehouse in the important trading centers from coast to coast and makes deliveries at least either f.o.b. factory or through a trucking system from the distributing centers. The advantage to the manufacturer is the elimination of all competition at the wholesale end and a possible control over retail markets. Not infrequently a direct savings in warehousing, transportation, and management has thus been effected.[10]

Quite evidently direct distribution is open only to the large manufacturing concern with wide national markets and broad financial resources. Smaller manufacturers have generally preferred to distribute through jobbers or brokers. But they have attempted in a similar way to eliminate friction in the wholesale stage of distribution. One method of achieving this end has been the granting of franchises to wholesalers; to individual jobbers are allotted sales territories within which competition is wholly eliminated. Another method, growing recently in importance, has been the withholding of the product from outlets which compete with the jobber-retailer channel; for instance, no sales are made to chain stores, mail-order houses or other direct buyers. In both events a situation is created in which competition is intentionally lessened.

Direct retail-price control has become customary for the higher-priced cosmetics, for refrigerators, automobiles, radios, and office equipment. Territorial restrictions or branch restrictions are imposed on retail distributors. Some manufacturers distribute through only a few retail outlets in each city; others restrict sales to dealers who are likely to promote the item, withholding it notably from price-cut stores. Since the Robinson-Patman enactment, manufacturers have frequently concentrated on either independent or chain stores. Others have withheld their products from syndicate chains or mail-order houses. In order to avoid friction between their retail outlets some producers have followed up selective distribution with selective packaging. The product is sold under the various trademarks or in different packages to independent stores, on the one hand, and to chain stores, on the other, or separately to drug and five and ten stores.[11] Since the Miller-Tydings Act legalized resale price maintenance in interstate commerce, the method of maintained retail prices has become customary in drug lines, in the book, liquor, and tobacco industries, and in selective groups of foods and dry-goods articles.

Apart from direct attempts to control retail outlets or retail prices, or both, manufacturers have used various methods of securing recurrent sales, such as long-term contracts with dealers, volume rebates, and other cumulative discounts. Significant economic effects have resulted from these various controls of manufacturers. Most

[10] See BECKMAN AND ENGLE, WHOLESALING PRINCIPLES AND PRACTICE (1938) c. 13.

[11] See HARING, RETAIL PRICE CUTTING AND ITS CONTROL BY MANUFACTURERS (1935) 135 *et seq*

noteworthy are serious imperfections in wholesale and retail markets. Increasingly larger portions of retail outlets have been brought into partial dependence upon, if not under direct control of, manufacturers. In some branches retailers have become virtual agents of the producer and have been entirely deprived of their freedom of selecting goods in the interest of the consumer. Instead of being an instrument for expressing market demand, such retail outlets have been chained to the supply side of the market, leaving the consumer without a proper representative in the array of marketing forces.

MARKET CONTROL BY DEALERS

In contrast to the foregoing practices which deal with producer-imposed market controls, we find also numerous controls imposed by dealers. Some of these controls operate in horizontal direction, while others present examples of vertical integration.

Relatively seldom do retailers or wholesalers resort to horizontal price fixing.[12] The larger number of sellers in distributive trade, the overlapping of their sales territories, and the lack of organizational discipline do not encourage price agreements among dealers. Occasionally such price control organizations are found in the drug field, in some lines of food trades, in the liquor industry, in some dry-goods trades, and particularly in the dairy field. Their strength varies as between trades and localities. Most commonly they are operating in limited local territories. They have reached considerable strength only in markets where state interference became an organizing factor, such as in the dairy industry, and in the pharmaceutical and liquor trades.

In modern retailing the most controversial practice is the loss leader.[13] The selling of articles at a loss or at no profit is a weapon that large-scale distributors, such as department stores, mail-order houses, chain stores and supermarkets have used against their smaller competitors. The loss leaders attract patronage from large trade areas. Especially advertised articles with a strong popular appeal became a favorite subject of price cutting. For the most part it was department stores, mail-order houses and chain organizations in the drug, liquor and tobacco field which used bargain sales; but gradually all types of retail stores were pulled into the whirlpool of price slashing. The margins of nationally advertised articles were depressed to a point which left no profits to their distributors, and thus indirectly injured the interests of their producers.

More recently loss-leader selling has assumed new aspects. Certain kinds of distributors, such as large department stores and some of the food chains, have denounced extreme forms of the practice. On the other hand, the method has gained importance as a less spectacular method of underselling. Department stores and supermarkets sell a large number of aggressively advertised standard brands at

[12] As to the various price and market controls introduced in production industries, see particularly BURNS, *loc. cit. supra* note 3; WATKINS, PUBLIC RELATIONS OF COMPETITIVE PRACTICES IN BUSINESS ENTERPRISE (1940).

[13] See SELIGMAN AND LOVE, PRICE CUTTING AND PRICE MAINTENANCE (1931); GRETHER, *op. cit. supra* note 7, at 199-224.

lower than average mark-ups but at no loss, in order to gain a reputation for reasonableness, while less advertised products, private brands, and unadvertised products of smaller manufacturers are carried at much higher mark-ups.

Again we are confronted here with imperfection of the market in that smaller rivals are unable to compete on the same level. The smaller retailer has to concentrate on items for which advertising has created wide consumer acceptance and recurrent consumer demand. He is unable to carry a large stock of slow moving items with higher mark-ups. Thus he finds himself unable to balance the loss from the price-cut items by higher prices on less advertised products. The lack of price information on the part of buyers operates to accentuate this imperfection. If consumers were fully informed about the price and quality of offerings they would realize that the impressive bargain front of the larger store hides many non-competitive articles with high mark-up, especially private brands of wholesalers and retailers.

Through the development of large-scale distribution, other monopolistic practices that we know from manufacturing industries have found entrance into the distributive trades. One such practice is the shifting of competition from price to service, selection, convenience, delivery and credit.[14] There evidently exists a cycle which runs through all stages of retailing. Large-scale distributors build up volume by rugged price competition, curtailing service, credit and delivery to a minimum. After having amassed considerable volume in their stores they introduce service features which increase their fixed cost and demand the maintenance of high profit margins and stable prices through intensified promotional pressure and enhanced services. This is what has happened in the department stores and mail-order houses, where margins have doubled during the last decade. In the chain-store and supermarket field similar trends are observable.

To a certain extent the goal figures of departmental accomplishments are working in the same direction of enhancing prices. These goal figures are guides to the department store manager in his control of buying prices, overhead expenses, and mark-downs. To the extent that the large stores are price leaders in their respective fields, the goal figures will tend to raise margins of other stores and thereby heighten prices to the consumer.

This price leadership of large operators is a phenomenon which has been particularly studied in production industries such as steel, meat packing and tobacco,[15] but is as frequent in distributive trades. Price leaders are to be found in almost every field in which large distributors account for a considerable portion of the total retail volume. The two large mail-order houses, the big corporate department stores, the national food chains, the chain drug stores are all occasionally assuming the

[14] Some authors, such as BURNS, *op. cit. supra* note 3, at 372 *et seq.*, include advertising in these imperfections. It may be asked, however, whether intensified advertising in retailing, in linking separate markets, has not increased rather than decreased price competition.

[15] See instances and economic analysis in BURNS, *op. cit. supra* note 3, at 77-145. For price leadership occurring in the gasoline retail industry, see Till, *Gasoline: The Competition of Big Business*, in HAMILTON, PRICE AND PRICE POLICIES (1938) 117, at 126.

rôle of price leaders in their respective fields. The two large dairy distributors and the integrated gasoline distributors have become established as price leaders in many markets. Price leadership is of varying impact on the market depending upon local conditions. Quite naturally, in a small community with a few stores a national chain organization would have a larger importance as a price leader than would a large department store in a city where there exist many competitors in specialized lines. A mail-order chain unit may be a price leader in the automobile accessory field while in men's furnishing lines it may be of little importance for the price structure of the community.

MONOPOLISTIC PRACTICES OF LARGE-SCALE BUYERS

The major imperfections of our distributive markets appear on the buying as well as on the selling side of the market and find their causes directly in the concentration of the distributive trades.

The "monopsonistic" buyer, as defined by economic theory, harvests a "consumer's surplus" at the expense of the competitive seller.[16] One practical materialization of the buying monopoly is the volume discount exacted by both syndicated buyers and individual purchasers. The volume or cumulative discount is given in consideration of the larger volume which an individual concern or group of buyers places with an individual seller. Not being related to the quantity of the individual order, it therefore has no direct connection with the cost to the seller. It presents perhaps the clearest form of a price discrimination in favor of larger retailers. It creates an imperfection of the market in that it places a small distributor at a distinct disadvantage and has been condemned as harmful competition since it does not reflect larger marketing efficiency.[17] Yet the volume discount like other forms of cumulative rebates has appeared[18] and will appear wherever close business connections are established between the large buyer and individual sellers.[19]

The quantity discount, more closely related to the cost concept, may represent direct savings of cost. Yet, since it is not always thus related, it has become the subject of extended controversy.[20] Carload buyers, especially in the department store, chain and supermarket fields are able to buy at considerable cost differentials. The argument in favor of the quantity discount is that smaller distributors could obtain the same advantage if they would pool their purchases in cooperative buying. Practically, however, only a limited group of retail outlets lend themselves to cooperative action of this kind. Because of the tremendous diversification of lines handled in a

[16] See ROBINSON, *op. cit. supra* note 1, at 223.

[17] *Cf.* H. C. Brill Co., Inc., 26 F. T. C. 666 (1938).

[18] A typical situation of this type exists in the clothing trades, especially in the ready-to-wear dress trade where large buyer syndicates are dealing with small-scale sellers. Meiklejohn, *Dresses: The Impact on a Business,* in HAMILTON, *op. cit. supra* note 15, at 370.

[19] See as to this question and other discrimination problems OPPENHEIM, RECENT PRICE CONTROL LAWS (1939) 123, and bibliography, 125. See also George, *The Robinson-Patman Act Begins to Acquire Meaning* (March 1940) 48 DUN'S REV. 20 *et seq.*

[20] See particularly the controversy centering around the Kraft-Phenix Corp. policy of a combined volume and quantity discount; also address of Federal Trade Commissioner Freer, March 24, 1938.

modern store, central buying requires centralization of management which independent outlets rarely are able to accomplish. The quantity discount, therefore, has to be considered as a distinct advantage to the large seller and cannot fail to encourage further concentration in businesses where it prevails.

Certain forms of indirect price discrimination, through disguised rebates, advertising allowances, favoritism in services, push money items and demonstrators have been the object of frequent discussions in trade circles. Their partial suppression by the Robinson-Patman Act has not entirely removed them from the retail scene and there can be no doubt that they continue to constitute imperfections of the market.

More serious trade impediments stem from attempts of buying groups to fix uniform purchasing prices. Outstanding among such bargaining attempts is the fixing of the base price for milk to be paid to farmers and agreed upon by the large milk dealers on the one hand and farm cooperatives on the other. Buyers are motivated by a desire to prevent competitive bidding among themselves for the available supply, and to secure a regular flow of supply throughout the year for such seasonal products as dairy products, eggs, fresh fruit and vegetables. It has been charged that large buyers in these markets exert monopolistic power over the widely scattered farmers. Sellers lack organization and in addition are subject to the pressure that the perishable nature of these products exerts on the market. Thus legitimate attempts on the side of buyers to regulate the flow of products to the advantage of both sellers and buyers are inseparably interwoven with efforts to tip the scales of marketing in favor of the better organized dealer groups.[21]

PUBLIC POLICIES TOWARD MONOPOLISTIC PRACTICES AS MARKETING BARRIERS

Public policies toward monopolistic practices in distributive trades are not uniform. Inspired by contradictory motives, they have created unequal results and quite often form barriers to effective marketing.

As the legal background of these policies we still find the anti-trust laws, which were written into the state and federal statute books long before our present system of distribution had emerged. These laws were devised to cope with phenomena arising in production and transportation industries, but did not lend themselves to the adjustment of conflicts arising under the quite different circumstances which prevail in distributive trades. The courts also failed to take cognizance of the reversal of economic forces in distribution. They frequently condemned concerted action among smaller merchants while the exploitation of atomized sellers by collective action of syndicated buyers, chains, and other powerful groups escaped legal attack.[22] As a consequence the anti-trust acts have been favorable rather than detrimental to the

[21] This is particularly true in many milk markets, where two large distributor groups exercise controlling influence. See the analysis by Till, in HAMILTON, *op. cit. supra* note 15, at 474-482. See also various reports of the Federal Trade Commission on the Sale and Distribution of Milk and various releases of the Department of Justice in cases against the Borden Corp. and National Dairy Products Corp., 106 C. C. H. 2 TRADE REG. SERV. (8th ed. 1937-1940) 17,004, 17,009, 17,012, 17,041.

[22] Meiklejohn, *supra* note 18, points out, at 363: "The dress manufacturers are in a far weaker bargaining position than the organized buyers. If they attempt combination, as the dress guilds did when they agreed to refuse to grant special discounts, they are guilty of restraint of trade."

development of monopolistic competition in distributive trades. They have not imposed checks on the growth of large-scale enterprise, have indirectly favored both vertical and horizontal integration, and have prevented small-scale enterprise from seeking salvage in cooperative organization.

Only with the depression did there come a partial reversal of this public attitude. The N.R.A. brought the small businessman to Washington and many of the codes of unfair competition took cognizance of the plight of the independent retailer and wholesaler in his struggle with his superior competitor. The N.R.A. was short-lived, but the cooperative spirit that had been generated through compulsory organization under the N.R.A. codes showed a more than ephemeral vitality. Directly sponsored by local N.R.A. groups, fair trade committees sprang up all over the country and raised the battle cry for legislative protection of the small independent businessman.

Foremost in the center of this legislative drive have been two practices—the loss leader and price discrimination. The economic philosophy which dominated prosecution policy under the Sherman and Clayton Acts had considered both price discrimination and aggressive price leaders as a form of price competition which only in extreme cases could upset marketing equilibrium. The law-enforcing agencies were committed to a theory of price equilibrium which did not take cognizance of the phenomenon of "monopsony" on the buying side of the market. But the people in Main Street frequently had a more realistic conception of the threat of large-scale enterprise and made energetic efforts to reverse public attitude.

Gradually the influence of small independent retailers succeeded in swinging the legislators toward their side. One state after another adopted laws which endorsed the independents' viewpoint and were pointed against big business. Technically most of these laws appeared as amendments to the state anti-trust laws and lifted price-fixing prohibitions or forbade price discrimination. Almost all of them adopted names that suggested a relationship to the concept of fair competition and trade.

As in many other fields of commerce, existence of non-uniform state and federal laws created an impediment to trade. One such divergence of attitude between federal and state authorities developed in regard to resale price maintenance. The drive for permissive legislation to allow vertical contractual price fixing was started by organized groups especially in the drug trade. It came as a reaction to the widespread use of nationally advertised, branded articles as loss leaders in the trade. The campaign for such permissive legislation succeeded in most of the states and led to the enactment of Fair Trade Acts.[23] These acts not only allowed manufacturers to fix uniform retail prices for their products but also forbade the underselling of such fixed prices by non-contract dealers. From the viewpoint of the national manufacturer, the legislation created a confused marketing situation. While under federal law it was unlawful to impose a contractual limitation on the retail price, under

[23] See analysis of these acts in GRETHER, *op. cit. supra* note 7, Appendix A, 403. Also, 106 C. C. H., *supra* note 21, at 10,001 *et seq.;* OPPENHEIM, RECENT PRICE CONTROL LAWS (1939) Pt. 1, at 62. States having these laws now total 44.

the law of many states the observance of fixed prices was mandatory. The federal Miller-Tydings Act of 1937, freeing interstate price maintenance from the restrictions of the Sherman Act, restored the balance between contradictory federal and state legislation. Under the new policy contractual price maintenance has been widely practiced by both local and national distributors.

Yet the fair trade movement was unable to shift the marketing balance to the side of the small independent retailer. The much publicized effects of resale price maintenance should be taken with a grain of salt. Laborious statistics have been compiled and presented by trade groups to demonstrate that resale price maintenance has enhanced the cost of living or that it has not. To the informed specialist, these statistics have hardly added much that he did not know before. The layman and the less informed economists have been misled into believing that Fair Trade Acts have created major shifts in distribution. Probably there is not a single field in which any change in distributional methods can be directly ascribed to the law. A single exception is perhaps furnished by the drug and cosmetic industries. The drug stores' minimum margins for national items previously subject to intensive loss-leader selling have been established and well enforced. But even in this field the general effect of the price stabilization on the industry has been relatively small, because retail competition was shifted to non-protected items, private brands and second grades. In the liquor field minimums were fixed by manufacturers of most national items, but the continuous price warfare, especially at holiday seasons, is testimony of the unsatisfactory enforcement of the acts. In the tobacco field four out of five large cigarette distributors have chosen to leave their prices unrestricted and in the food field price maintenance efforts are limited to a few brands which are only small islands in the big seas of distribution. In such industries as hardware, radio, and gasoline, price stabilization efforts under the Fair Trade laws have scored only ephemeral success.

Another trend of legislative thought is embodied in the Unfair Sales Acts,[24] enacted in about half of the states. By forbidding sales below cost these laws provide a more elastic price rule against the loss leader. For while the Fair Trade Acts allow manufacturers of branded articles to fix a uniform retail price, the Unfair Sales and Practices Acts prohibit loss-leader use directly in defining a cost price below which retailers are not supposed to mark up their commodities. Consequently, these laws apply not only to branded but to all kinds of commodities, and they make it unlawful for the retailer to sell below a certain minimum mark-up even if the manufacturer himself does not want to have retail prices maintained. The efficient enforcement of this type of law depends entirely on the existence of a vital trade organization which supervises the price behavior of retail stores and advises the public attorney on prosecution of violators. The Floor Price laws have been frequently attacked as price fixing statutes and partly voided by federal and

[24] For an analysis of these acts see *ibid.*

state courts. It seems, however, that the principle of a minimum cost price has survived the judicial ordeal.[25]

The effects of Unfair Sales Acts are also less than voluminous economic discussions and government reports would suggest. Practically, only in the state of California—and here again only in the food trade—has an organized attempt been undertaken to ban the loss leader. The retailer groups were active in prosecuting chain stores, supermarkets, and also smaller price cutters. They succeeded in piling up a bulky record of court cases and administrative precedents but were unable to check the growth of chains, supermarkets, and other price-cutting retail organizations which flourish in California more than anywhere else.

In the matter of price discrimination the federal legislator has led the state law givers. Again, as in price-fixing, the legislative curative has been proposed and endorsed by pressure groups in the distributive fields. Wholesalers and independent retailers clamoured for a ban on special discounts which their larger chain-store competitors were able to exact from manufacturers and farmers. In form, the Robinson-Patman Act against price discrimination was an amendment to the Clayton Act, which already had an anti-price discrimination clause. In fact, it reflected an entirely new idea. The Clayton Act was chiefly aimed at the practice of local price differentials. Its factual background was the violent methods allegedly used by the older trusts to drive independent competitors out of business by underselling them in their local sales territories. Significant emphasis of the Clayton Act was thus on the selling side of the market.

The Robinson-Patman Act is aimed at the mass buyer. Chain stores, mail-order houses, department stores and buying syndicates have become the chief defendants in anti-trust prosecution under it. While under the Clayton Act the seller violated the law when paying extra dividends or rebates to dealers, the amendment made it illegal to accept discriminatory discounts. The economic doctrine of the consumer surplus was thus written into the law. It prohibited discriminatory discounts not justified by cost savings. Since the law operates mostly in the wholesale field including such mass retail buyers as supermarkets, chain stores, and mail-order houses, it is mostly interstate in scope, but it is supplemented for the realm of intrastate commerce by numerous state laws.

After four years of operation the Robinson-Patman Act has gained sufficient practical meaning to become an operative factor in distribution.[26] To the disappointment of those who helped draft the original bill the force of the act did not carry our distributive system to the ends which the master craftsmen of the draft had anticipated. Purporting to strike a balance between the buying power of the "little fellow" and the mass distributor, the act caused some manufacturers to discontinue trade with the little fellow altogether. Others, whose lot was more clearly cast with the mass of small-scale distributors, established warehouses of their own in the distributing centers. This was definitely not to the advantage of the wholesaler

[25] See OPPENHEIM, *op. cit. supra* note 23, at 63 *et seq.*

[26] See George, *supra* note 19.

sponsors of the act; nor have brokers had reason to rejoice at the effects of the anti-brokerage clause of the act, which has caused some large national chain systems to discontinue all relations with brokers. As a whole, selective distribution has been greatly encouraged by the act. Many producers distribute now exclusively to chains or jobbers, others use specialized selling under distinct brands or with distinctive packages. Such specialized selling is undertaken to make the article less competitive in the distributive field and constitutes therefore an imperfection of the market directly traceable to the Robinson-Patman Act.

Another outstanding change in distributive practices has been seen in the discontinuance of many volume discounts. It is hard to ascertain to what extent large buyers are still able to secure such discounts in disguised form, for instance as advertising allowances, cash discounts, or in free goods. As a rule manufacturers are now more anxious to base price differentials on true cost differences; they also base advertising grants to dealers on services performed and try to arrive at price scales which classify rather than individualize.

For one thing it appears that neither the chain, the buying syndicate nor the giant superstore against which the Robinson-Patman Act was directed have been stalled in their triumphant forward march. The chains have grown larger, the buying syndicates more powerful, the mail-order houses more voluminous despite Robinson-Patman. If we try to assemble the individual marketing effects into a general picture we see no radical changes ascribable to the altered public policy.

The passing of such legislation as the Robinson-Patman Act, the Fair Trade Acts and the Unfair Practice Acts was hailed by the independents as a first victory in their drive against the chain store. More radical legislation was then proposed to prevent national chains from establishing further branches throughout the country, from intergrating wholesale activities, from manufacturing their own brands. Discriminatory-price tax bills were laid before city councils, state governments, and finally before the national legislature. The federal measure, the Patman Anti-Chain Store Bill, has gained nation-wide fame.[27] The measure was twice defeated in Congress despite the considerable strength that had been assembled among members of both houses. Although under present conditions its early reappearance in Congress is not very probable, it is most significant in the rigidity of its terms. Under this law such cumulative taxes would have been laid upon all national chains as to force the largest groups in the grocery field to go out of interstate operation. Even though this federal attempt failed, it constituted a serious barrier to interstate commerce during its consideration. To the large national chain corporations its cumulative tax schedule constituted a threat to their very existence. The bill had a definite effect on chain marketing policies of the thirties. Besides, even with the

[27] For an analysis of the bill see *The Patman Tax Bill on Chain Stores* (1938) 2 TRADE REG. REV. No. 4. See also 1-4, *Hearings Before the Subcommittee of the Senate Committee on Ways and Means on H. R. 1*, 76th Cong., 3d Sess. (1940).

defeat of the Patman Bill in Congress, there is left enough state legislation seriously to stifle the growth of chain distribution.[28]

While some communities were able to ban supermarkets and chains altogether through city ordinances of drastic proportions though of doubtful constitutional validity, some states, particularly in the South, imposed taxes which checked the further growth of corporate chain distribution. Again it is quite significant for the haphazard effects of legislative streamlining that the purpose of the law was perverted in many ways. Devised as an anti-chain measure, discriminatory chain taxes have had their most important effect on multiple retail units operated not by chains but by oil refinery companies. Existing taxes and the threat of future taxation caused oil companies to divest themselves of their holdings of filling stations. Another effect of chain taxes has been the formation of supermarkets in the grocery field. In fact, the transformation of many small chain-store units into large supermarkets is directly traceable to the desire of corporate chain stores to avoid the relatively small profits of a chain neighborhood store. Undoubtedly, the consolidation of small stores into large potent supermarkets has injured rather than helped the small independent grocer for whose benefit the tax protagonists had struggled. But here, as in the field of the Robinson-Patman price control attempts, it is difficult to determine with mathematical exactitude the strength of legislative and marketing forces which join to make our distributive structure at once more competitive and more monopolistic.

[28] For an analysis of chain tax legislation see Wolff, *supra* note 5; *cf.* Feldman, *Legislative Opposition to the Chain Store and Its Minimization*, *infra* this issue.

LEGISLATIVE INTERVENTION IN THE CONFLICT BETWEEN ORTHODOX AND DIRECT-SELLING DISTRIBUTION CHANNELS

Joseph Sidney Gould*

Darwin's truism that in nature nothing is constant except change is applicable to most phases of human activity and social relationships. It is particularly true of the field of merchandising or distribution. Despite this, there is an aspect of human nature which tends to retard change—a native conservatism. Old customs, methods, become crystallized in tradition. Once established, each agent in the field of distribution, regardless of type, persists in claiming to be the "regular" or "orthodox" channel. All newcomers are regarded as mere interlopers. So it is that today distribution through the wholesaler, jobber, and established retail merchant has become institutionalized into the orthodox scheme of merchandising; and channels for the distribution of goods and services which defy this pattern are viewed as unorthodox, a threat to the established mode of doing business. Just as self-preservation is a law of individuals, so is it a principle of vested institutions. Today's conventional pattern of distribution has not let the challenge of its supremacy go unheeded. It has sounded the cry of battle in the market place; but, increasingly uncertain of victory there, it has sought to entrench itself behind the wall of legislation. Peddler, chain store, transient merchant, vending machine, mail order house, department store, market cooperative—all have become involved in the legislative decision to play favorites in the economic struggle thus precipitated. A part of the story of this legislative intervention is told here.

Mobile Merchants

The house-to-house salesmen employed by manufacturing and distributing concerns as well as independent itinerant vendors, peddlers, and transient merchants may be distinguished from the so-called orthodox distributors by their mobility, since they move from locality to locality without regard to municipal and state boundaries. It is a commentary on the present-day classification of this group as interlopers that they have played such a prominent part in the history of merchandising. In the Middle Ages, the regular type of trader was either an artisan who traveled from place to place with goods he himself manufactured, or the peddler who purchased

* A.B., 1921, M.A., 1922, Clark University; Ph.D., 1929, Brookings Graduate School for Economics and Government. Head of the Department of Economics and Business Administration; Director of the Bureau of Economics and Business Research, University of Delaware. Contributor to periodicals.

stocks of goods in a town or at a fair and carried them about in a pack for sale. Since much of the commerce of Europe in the thirteenth, fourteenth, and fifteenth centuries was transacted at fairs, the itinerant merchant or peddler served an important need because it was impossible for everyone to visit the fairs or market towns for the purchase of goods. The peddler who purchased the goods at these markets or fairs carried them through the countryside selling to the people in their homes or bartering for goods which could be disposed of to advantage.

This same valuable economic function was performed by the hawker, peddler, and itinerant merchant in our early American life. The rôle of the Yankee peddler in the development of America is interestingly depicted in *Hawkers and Walkers in Early America*.[1] During much of the early history of our country, peddling was an active form of retail distribution, many New England and Pennsylvania factories owing their early start to sales made by such peddlers.[2] These traders and peddlers, actually the forerunners of our domestic commerce, were of various types. There were the general peddlers who hawked useful "Yankee" notions—pins, needles, hooks and eyes, scissors, razors, combs, buttons, spoons, small hardware, books, shawls, cotton goods, lace, and perfume. Then there were the specializing itinerant merchants such as the tin peddlers of essences, dyes, woodenware, pottery, books, and similar items. However, even these specialists frequently carried several sidelines of goods, vending such cumbersome articles as sewing machines, spinning wheels, cabinet organs, and agricultural machinery. Peddlers were further classified as "trunk peddlers," that is, dealers in small wares, essences, and such, who carried their goods in one or two small oblong tin trunks slung on their backs by a web harness or a leather strap, and peddlers who loaded large wagons with dry goods, hats, boots, shoes, clocks, firearms, hardware, and even furniture. The latter merchants travelled greater distances.

The early peddlers were comparatively young men who were adventurous and "able to cope with the dangers of the wilderness through which they had to travel."[3] With the passage of years, as the roads became safer and the wilderness was cleared, peddling slipped into the hands of older men. Both the young and the old peddlers played an important rôle in the widening of our frontiers. The first commercial move westward was made by Indian traders—by traders and peddlers who carried goods from New York and Pennsylvania into the territory lying beyond the fringe of the settlements. The Dutch of New York were trading regularly with the Iroquois at Albany by 1700 and the Pennsylvanians crossed the Alleghanies with their pack trains and penetrated to the Ohio and the Wabash in the early part of the eighteenth century. Although in general the reputation of the early Yankee trader was not very savory, as is well indicated by the observation of visitors to our country even as late as 1833, it must be remembered that many prominent men in

[1] WRIGHT, HAWKERS AND WALKERS IN EARLY AMERICA (1927).
[2] CONVERSE AND HUEGY, ELEMENTS OF MARKETING (1940) 49.
[3] WRIGHT, *op. cit. supra* note 1, at 24.

our American life started their careers as peddlers. This list includes such names as Collis P. Huntington, Parson Weems, and Benedict Arnold.

The status of the peddler and itinerant merchant today can be seen from the following table, which indicates the relative importance of house-to-house selling in the distributive field. It is to be noted that during the depression period the peddler, canvasser, and others engaged in direct-selling activities increased in number, and declined when economic conditions improved. The increasing facilities of transportation have given these mobile merchants such a competitive status as to arouse the merchants who operate established stores. In fact this competition is deemed to be so keen that in many municipalities and states ordinances and laws have been passed ostensibly designed to prevent unfairness in competition, to equalize the burden of taxation, and to prevent fraud on consumers. However, in many instances the intent was farther reaching, and litigation ensued. In a number of cases the courts have held these laws and ordinances to be unconstitutional, either because the regulation was too severe, the tax too large, competition too completely stifled, or the burden an unreasonable one on interstate commerce. In point is the unanimous decision of the United States Supreme Court, on December 23, 1940, which invalidated a North Carolina law imposing a $250 privilege tax on transient merchants or out-of-state retailers displaying wares in sample rooms of hotels.[5]

TABLE I

CONCERNS ENGAGED IN HOUSE-TO-HOUSE SELLING[4]

ESTABLISHMENTS			SALES		EMPLOYEES		
Year	Number	Percent of Total Retail Establishments	Total in Thousands of Dollars	Percent of Total Retail Sales	Per Establishment	Percent of Total of all Retail Establishments	Expenses as Percent of Sales
1929	1661	0.1	93,961	0.2	18.6	0.7	45.0
1933	7026	0.5	187,368	0.4	5.2*	1.3	40.9
1935	6349	0.4	125,316	0.4	5.3	0.8	41.5

* Full time only.

The power of states to regulate, license, and tax mobile merchants is generally recognized as well established, although the power actually to prohibit them from engaging in business is highly questionable, except perhaps as to the prohibition which may be imposed on the peddling of goods considered to be injurious to public health, morals, or welfare. The manner of imposition of license fees on peddlers varies among the several states. Some impose a tax upon the occupation, while others adhere to any one or a combination of the following classifications: (1) according to article sold, (2) according to the method of transportation, or (3) according to the population of the sales area. Thus in Alabama[6] a state fee of

[4] ALEXANDER, MARKETING (1940) 180.

[5] Best & Co., Inc. v. Maxwell, 311 U. S. 454 (1940).

[6] Ala. Acts 1935, No. 194, §348, schedules 104, 146; Acts Ex. Sess. 1936, No. 43; Acts 1936-1937, No. 230; Acts 1939, No. 18.

$250 and a county fee of $125 are imposed on a peddler of drugs, ointments, and medical preparations professed to treat or cure disease, injury, or deformity, not including patent medicines sold in original packages. These fees are not modified by the mode of transportation used in selling the listed items. However, in the vending of patent and proprietary medicines and household remedies in original packages, such as toilet articles, spices, extracts, flavoring, soaps, insecticides, stock and poultry supplies, the tax varies as follows:

(a) When using a motor vehicle for transportation, $40 state and $40 county.
(b) When using other than a motor vehicle for transportation, $20 state and $10 county.
(c) When travelling without a vehicle, $10 state and $10 county.

In addition to the above there is a general tax on all vendors and itinerant merchants of $15 state and $5 county when using a vehicle other than a motor car.

A departure from the above bases is to be found in the new type of regulatory law passed by the state of Nebraska in 1937.[7] Under it the license fee is imposed not upon the privilege of doing business as an itinerant merchant but rather as a payment for the use of the state's highways to transport the goods to be sold. It is claimed that the law was occasioned by the marked increase in the use of the highways by itinerant truckers. Five other states, California, Iowa, Montana, Wisconsin, and Wyoming, enacted laws in 1939 which were closely patterned after that of Nebraska.[8] The license fee varies considerably among these six states. In Nebraska an itinerant merchant must pay an annual license fee of $25 and an additional occupation tax of $25 on each vehicle he uses in his business. In California and Wyoming the fee is $10, while Montana requires an annual license fee of $100, and Wisconsin $200. Iowa imposes a fee based on the maximum weight of the load to be carried where the vehicles are not registered in the state. The schedule is as follows: load not to exceed 1000 lbs., $10; load not to exceed 3000 lbs., $25; load in excess of 3000 lbs., $40. If the vehicle is registered in the state, the fee is $2 regardless of the weight of the load. All six of the states require the posting of a surety bond ranging in amount from $250 in California to $1000 in Montana. Wisconsin requires two bonds, one of $500 to guarantee the payment of all taxes, penalties, and interest, and another amounting to $1000 to protect the public from fraud.

In order to strengthen the hand of the several states in passing legislation designed to regulate the activities of peddlers and itinerant merchants operating interstate, bills were introduced in the 76th Congress of the United States. Illustrative is H. R. 8796, providing that "no individual engaged in selling or in soliciting orders for goods, wares, or merchandise, or other commodities shall be relieved, by reason

[7] Neb. Laws 1939, p. 669.

[8] *Laws and Ordinances Regulating Transient Dealers and Closing Out Sales* (Am. Retail Fed., 1939) 13. A comparable development has taken place in the municipal area, with some litigation resulting. See McIntire and Rhyne, *Municipal Legislative Barriers to a Free Market, infra* this issue.

of his relation to interstate commerce, from the operation of the laws of any State, or political subdivision thereof, requiring licenses or bonds of, or otherwise regulating the activities of, individuals so engaged."[9]

A 1939 analysis made of the principal state statutory provisions concerning peddlers[10] reveals that while all the states to a greater or lesser extent regulate this activity in a restrictive manner, many make specific exemptions which are distinctly promotive in their incidence. In Indiana and Kansas residents are exempted; in New York licenses are required only of those selling foreign-made goods. Twenty states exempt persons selling dairy, poultry, or farm products produced by themselves; New Mexico and Wisconsin do so where the peddler is a resident of the state. Thirteen grant this exemption of agricultural products to all peddlers whether or not they were themselves the producers; twenty-one name other types of articles the peddling of which is exempted from licensing requirements; while seven apply the principle of self-production broadly to include all types of manufactured goods.

Similar analysis of transient merchant laws[11] reveals like tendencies. Of the twenty-eight states requiring the licensing of transient merchants, as variously defined, about half provide one or more kinds of exemptions identical with those granted in the case of peddlers. Thus four states specifically exempt persons selling farm and garden products raised by themselves, New Mexico again limiting the favor to residents. Four more jurisdictions extend the grant to goods manufactured as well as produced by the one selling; while another three specify that transient sale of agricultural products, whether or not raised by the seller, is exempt, with four others applying this principle to perishable farm products sold at any established municipal market.

It would thus appear that in some of the states the regulatory provisions aim to do more than "protect" or "equalize competitive advantages" between fixed and more permanent as against the mobile and more transitory channels of distribution. By means of exemptions the statutes decidedly discriminate between agricultural and other commodities. It is not the type of merchant that is exempted but the merchant who sells a type of commodity. This is especially true in the case of those states which exempt persons selling agricultural products whether or not raised by the seller.[12]

MAIL-ORDER HOUSES

The ordering of goods by mail is a practice as old as the mails; the establishment of a retail business dependent solely upon mail orders is comparatively modern. The

[9] H. R. 8796, 76th Cong., 2d Sess. (1940). Compare H. R. 9045 of the same session providing that "no individual, association, or corporation engaged in selling or in soliciting orders for goods, wares, or merchandise or other commodities as itinerant vendors, transient merchants, and mail-order merchants shall be relieved by reason of his relation to interstate commerce, from the operation of the laws of any State or political subdivision thereof in which he may operate and where no discrimination is made against such individual, association, or corporation domiciled within this State providing for taxation, licensing, regulation, or supervision of such activities of individuals, associations, or corporations." [10] *Supra* note 8, at 14. [11] *Ibid.*

[12] Diverse forms of product favoritism by government are discussed in *Note on Governmental Product Favoritism, supra* this issue.

history of the mail-order business is essentially that of the two leading firms, Montgomery Ward, Inc., founded in 1873, and Sears, Roebuck & Co., established in 1893, and of Chicago, whose geographical position made her the logical home for the major companies in the business. A. Montgomery Ward and his brother-in-law George R. Thorne considered the original aim of their business "to serve as a supply house for the farmers' granges."[13] Among the objectives of the grange movement was the encouragement of cooperative buying. When this feature of the movement did not prove successful, they decided to enter the mail-order business.

Sears, Roebuck & Co. owes its origin to an interesting venture on the part of Mr. Richard Sears when he was a station agent in New Redwood, Minnesota. When Mr. Sears notified a mail-order watch company that the customer to whom a watch was to be delivered C.O.D. could not be found, they replied urging him not to return the watch but to sell it to someone else. He did so and netted a profit of $2. This experience prompted him to order other watches which he sold at a similar profit. It was not long before he left the employ of the railway concern and started a watch and jewelry mail-order business of his own in Minneapolis. This business he moved to Chicago and after a few years disposed of it profitably. It was not long, however, before he and A. C. Roebuck, a watch repair man, started another mail-order house in Minneapolis under the name of Sears and Roebuck. Within five years the concern showed remarkable growth and again the strategic location of Chicago was a factor in deciding to move the business to that city.

There were two dominating reasons for the growth of the mail-order business—sale of goods not readily available in small communities, and prices lower than those of local retailers. It is in these communities that marked competition between mail-order concerns and regular stores has occurred most noticeably. The mail-order houses apparently forced local retailers to reduce their prices.[14] To realize the keenness of the competition it is necessary to recall the intense hostility of rural and small-town merchants towards the mail-order houses.

The appearance of any new form of distribution has always caused established retailers to fear the complete abolition of the independent merchant. It is so in the present conflict with the chain stores. It was so with the coming of the department stores and the mail-order houses. Today, of course, the department store is an accepted, established American institution. But there was a time, beginning with John Wanamaker's "Grand Depot" in Philadelphia, opened in 1876, when the department store loomed as the great threat to the existence of small enterprise. No effort was spared by local merchants to turn the ill will of the public towards these newer enterprises. Attempts were made to regulate them by discriminatory legislation.[15] For example, in Pennsylvania "a bill was introduced providing for a total of $100,000 in license fees to be collected from the department stores of the

[13] NYSTROM, THE ECONOMICS OF RETAILING (1919) 288.
[14] CONVERSE AND HUEGY, *op. cit. supra* note 2, at 348.
[15] NICHOLS, THE CHAIN STORE TELLS ITS STORY (1940) 127.

Commonwealth. A year later, the State of Missouri passed a law taxing the department stores $500 on each and every classification of goods sold."[16]

Agitation against the mail-order houses followed the same pattern. Montgomery Ward and Sears, Roebuck & Co. became the targets for many "lecturers" particularly in the Southern and Middle Western states. In some states political aspirants made issues of the mail-order houses and urged legislation to curb their growth. In many towns "high bon-fires in the public square destroyed mail-order catalogues in order, local merchants said, to keep 'freedom of opportunity' alive in America."[17] More recently, manifestations of hostility have appeared in the form of "sticker" ordinances, the purpose of which is to discourage the mail-order selling of plumbing supplies, and in the barrier features of state use taxes.[18] Local building codes, drafted in the era before pre-fabrication of dwellings and calling for construction standards differing from those properly used in pre-fabrication, are also being employed to strike at the direct selling of this new product through both general variety and single commodity mail-order houses.[19]

Nevertheless, direct-by-mail selling has progressed despite such attempts to hamper its growth until today it has attained a rather respectable, accepted status. In 1935 there were 378 establishments in the United States with nearly 41,000 employees, making a volume of catalogue sales amounting to 420,000,000 dollars. It is estimated that between two-thirds and three-fourths of this volume of business was done by the two largest concerns in the field.[20]

Although mail-order houses are principal distributors to farmers, the larger concerns no longer consider the rural areas their major field for sales. An accurate break-down of the sources of revenue of the three leading companies is not available. However, it is believed that the proportions of urban and rural sales are close to the national division of approximately 65 percent urban and 35 percent rural. With the exception of Sears, Roebuck & Co., so-called urban sales come primarily from the small-sized communities. The recovery of sales by the mail-order house from the low levels of the depression years is indicated in Table II. It is significant that while the percentage of total retail sales for all distributive agencies for the year 1939 was only 84 percent of the year 1929, the mail-order houses reached a record of 90 percent of 1929 in the year 1939.

[16] *Id.* at 127. The Missouri type legislation, constituting an early form of limitation on integration in the distributive field, is discussed in Cook, *Legislative Restrictions on Marketing Integration*, *supra* this issue.

[17] NICHOLS, *op. cit. supra* note 15, at 128. See also COHN, THE GOOD OLD DAYS (1940) 510 *et seq.*

[18] The "sticker" ordinances are referred to by McIntire and Rhyne, *Municipal Legislative Barriers to a Free Market*, *infra* this issue; on the use tax, see Carlson, *Interstate Barrier Aspects of the Use Tax*, *supra* this issue. See also note 22, *infra*.

[19] See McIntire and Rhyne, *Municipal Legislative Barriers to a Free Market*, *infra* this issue. MAYNARD, WEIDLER AND BECKMAN, PRINCIPLES OF MARKETING, (3d ed. 1939) 130 *et seq.*, list four types of mail-order retailing. Concerns representing three of these types now offer pre-fabricated houses.

[20] ALEXANDER, *op. cit. supra* note 4, at 204.

TABLE II[21]

VOLUME OF MAIL-ORDER SALES (CATALOGUE ONLY) 1929-1939

Year	Volume of Sales (in millions of dollars)
1929	595
1930	349
1931	259
1932	201
1933	244
1934	300
1935	420
1936	460
1937	490
1938	463
1939	519

In 1925, Sears, Roebuck & Co., and in 1926 Montgomery Ward, entered the urban communities by the establishment of a chain of retail stores in many cities from coast to coast. This put them in the retail field as large national chain-store companies and therefore subject to all the restrictive and regulatory legislation directed against chain stores.[22] A second recent development in the mail-order field is the rise of the cooperative mail-order houses, of which there are now two outstanding companies.[23] Thus are combined two direct-selling distribution channels.

VENDING MACHINES

While at one time or another during the past forty years vending machines have been used for the retailing of a wide variety of products, the remarkable growth of this novel method of distribution took place during the past few years. There are no census figures available on sales made by vending machines. In 1933, however, it was estimated that there were 6,000 operators, the three largest of which controlled nearly 200,000 machines.[24] These figures do not include gambling devices, scales, games, lockers, and other machines vending a service only. Data compiled by associations in the vending machine business indicate that the industry multiplied itself tenfold during the period 1928 to 1939. The estimated value of coin-operated equipment sold annually approximates $75,000,000.[25] The production of coin-operated machines used for commodity vending has had a noticeable

[21] *Industry Surveys* (Dec. 6, 1940) 48 STANDARD STATISTICS No. 20, §2, p. RT-14; and *Retail Chains and Mail-Order Houses*, CENSUS OF BUSINESS 1935 (U. S. Dept. Com., 1937) 27.

[22] This particular form of legislative intervention in the struggle between competing distribution channels is detailed by Feldman, *Legislative Opposition to Chain Stores and Its Minimization, infra* this issue. By recent legislation in Minnesota, mail-order establishments in that state under the same management, ownership or control are taxed many times heavier than are other chains. See Minn. Laws Sp. Sess. 1937, c. 93, now MINN. STAT. (Mason, Supp. 1940) §§5887-18a-58887-18t.

[23] For details, consult BURLEY, THE CONSUMERS' COOPERATIVE AS A DISTRIBUTIVE AGENCY (1939).

[24] CONVERSE AND HUEGY, *op. cit. supra* note 2, at 332, quoting from Geo. B. Keck, *Vending Machine Merchandising* (Thesis for Master's Degree, University of Illinois, 1933).

[25] Schlicht, *The Coin Machine Business* (Aug. 1939) AUTOMATIC AGE.

growth. Census statistics show a rise from 102,700 in 1933 to 475,415 in 1937. The principal use of vending machines at the present time is for the sale of five specific products—gum, nuts, candy, cigarettes, and soft drinks. However, the full diversity of commodities distributed through coin-operated machines includes music, ice, wood, stamps, stationery, soap, towels, razor blades, handkerchiefs, collars, collar buttons, even perfume. There is almost no end to this list.

In 1935, cigarettes valued at $30,000,000 were sold from automatic vending machines. This tremendous volume is impressive when compared to the mere $200,000 gross when the cigarette vendors were first introduced only four years earlier. Chewing gum sales from machines at one cent a stick netted a total revenue of more than $5,000,000 in 1935. A single operator of peanut vendors reported sales of from 15 to 20 tons a month at the rate of half an ounce a penny. Another operator sold more than 1,000,000 pounds of pistachio nuts in small driblets in less than a year. During five months of 1934 twelve carloads of a certain candy bar were sold through 150 vending machines located at the Century of Progress grounds. In the subways of New York the vending machines are said to have annual gross receipts of approximately $1,000,000. There are some 7,000 such machines on Chicago's elevated railroad platforms.[26] The vending machines are located in thousands of railway and bus stations, and in other public places. They are to be found in America's industries among the lathes and presses of automobile factories, steel mills, packing plants, large retail stores, mail-order houses, and a variety of service establishments from restaurants to gasoline filling stations.

The phenomenal growth of this new distributive channel has already brought forth adverse criticism and even a number of attacks.[27] To what extent this adverse reaction has imbedded itself in legislation is, however, difficult to gauge. Prohibitory legislation forbidding in three states distribution by vending machines of drugs, medicines, or poisons,[28] and in one municipality sale of gasoline through automatic pumps,[29] cannot definitely be said to be the product of competitive pressure rather than of genuine considerations for public safety. The same is true of the taxing and licensing legislation now to be found on the statute books of at least seventeen states;[30] the evidence on the point is certainly meager. The operators insist that

[26] Slawson, *Selling by Machinery* (July 1937) 25 NATION'S BUS. 69. Some data on the magnitude of machine candy bar sales can be found in Hershey Chocolate Corp. *et aux.*, 28 F. T. C. 1057 (1939).

[27] See Schlicht, *supra* note 25.

[28] PA. STAT. ANN. (Purdon, Supp. 1940) tit. 18, §4659; CAL. BUSINESS AND PROFESSIONAL CODE §4010; KAN. GEN. STAT. ANN. (Corrick, 1935) §65-650.

[29] The Red Cloud, Nebraska ordinance was sustained against attack in Hawkins v. City of Red Cloud, 123 Neb. 487, 243 N. W. 432 (1932).

[30] Ala. Acts 1939, No. 398, amending Ala. Gen. Acts 1935, No. 194, §348, sch. 135, 154; 2 ARK. DIG. STAT. (Pope, 1937) §13420, amended Ark. Laws 1939, act 201; Del. Laws 1939, c. 67 §1; FLA. COMP. GEN. LAWS (Supp. 1940) §1279 (19); Ga. Laws 1935, pp. 42-43; 6 LA. GEN. STAT. (Dart, 1939) §8607 (mechanical musical instruments only); Miss. Laws 1940, c. 122; MD. CODE ANN. (Flack, 1939) art. 56, §23 (music boxes only); NEB. COMP. STAT. (1929) §41-104 (sandwich and lunch machines only); N. C. CODE ANN. (Michie, 1939) §7880 (61); Okla. Laws 1939, c. 66, art. 18, §4(d) (cigarette vending machines only); S. C. Acts 1939, Act 346, §101, (1) (a); S. D. CODE ANN. (1939) §§57.4101, 57.4102; TENN. CODE ANN. (Williams, Supp. 1938) §§1248.72 (a), 1248.73 (c); TEX. STAT. (Vernon,

merchandising through the vending machine is a supplementary rather than a competitive channel of distribution. To a certain extent this is true, especially when the machine is located at a place where were it not for it no purchase would be made at all. However, it is not unreasonable to question the implication that all purchases from the "thousands" of vending machines always represent untapped "new demand" that would otherwise go unsatisfied. Thus the American Federation of Musicians claims the displacement of professional musicians where coin-operated "juke boxes" have been placed in the larger cafes and dance halls. This organization at least does not view as protective the taxes on these music machines that range from $5 to $100 annually.

A stiff tax may not, however, be indicative of a purposeful intent to checkmate this new mode of distribution; the picture is confused by the fact that the slot machine has a reputation for both money-making and bad morals, either of which may explain high rates of tax. It would seem clear, for instance, that New York's authorization of municipal taxation of possession and operation of vending machines as a method of providing subsidies to housing authorities,[31] is prompted by the apparent taxable capacity of the merchandise vending machine. On the other hand, state authorization of taxation by local subdivisions coupled with heavy taxes by the state itself must by its very cumulative weight have restrictive effect. Thus under North Carolina law[32] music machines can be and are taxed $20 per year, soft drink machines $60, although the localities are limited to 50 percent of the state rate.[33] While some states carry a limited authorization to local subdivisions[34] or none at all, Virginia sets no limit.[35] The secretary of one of the vending machine trade associations considers a unit tax of even one dollar per year to be prohibitive for most types of merchandise vending machines. By this test much of the legislation must be deemed restrictive in its effect if not in its purpose. But if this seemingly low threshold is upped ten times the rates of some of the states would still meet the test of restrictiveness, and current proposals in the 1941 legislative sessions appear to run in the direction of exactions so heavy as to imply a definite purpose to effect competitive discrimination.[36]

1936) art. 7047a-1, amended Tex. Laws 3d Sess. 1936, c. 495, art. III, §4; VA. TAX CODE §§190, 198; W. VA. CODE ANN. (1937) §916, amended W. Va. Laws 1939, c. 1191, §10.

[31] N. Y. CONSOL. LAWS, c. 44A, §110. The tax is not to exceed 50 cents per month. Excepted are machines placed in buildings owned or leased by federal, state, or city government or public authority.

[32] N. C. CODE ANN. (Michie, 1939) §7880 (61).

[33] See also Miss. Laws 1940, c. 122, where the state schedule, with a 50 percent municipal exaction additional, is as follows: (1) weighing machines $5; (2) postage stamp machine $2; (3) pictures, music or stencils: less than 5 cents, $4; 5 cents to 10 cents, $10; 10 cents to 20 cents, $20; over 20 cents, $30; (4) games: up to 5 cents, $8; 5 cents to 10 cents, $20; 10 cents to 20 cents, $40; over 20 cents, $60; (5) merchandise: up to 5 cents, $2.50; 5 cents to 10 cents, $10; 10 cents to 20 cents, $20; over 20 cents, $30; and (6) cigarettes (where privilege tax on selling cigarettes has been paid), $2.

[34] Of the seventeen states imposing fees or taxes, three, including North Carolina, authorize additional local exaction. Ala. Acts 1939, No. 398; Miss. Laws 1940, c. 122; N. C. CODE (Michie, 1930) §7880 (61).

[35] VA. TAX CODE §198.

[36] *E.g.* Cal. A. B. 966, imposing a $25 annual tax on each cigar and cigarette vending machine; Ind. H. B. 316, imposing on all vending machines rates of from $3 for 1 cent machines to twice the sum

Many of the states provide for a variety of exemptions from the license or tax. The following provisions are found in the Alabama law:[37] (1) machines vending necessary articles on a non-profit basis to employees are exempt; (2) exemption is also granted where a person, firm, or corporation operating the place of business, or owning the machine, has a privilege license to sell the articles vended by machine. In case of vending to employees on private property (apparently on a profit basis), no license is required if in lieu thereof the operator of the machines obtains an occupational license. Florida provides exemption from county and municipal license of operators of drinking cup and stamp machines when located in public conveyances.[38] Machines vending drinking cups and those machines making non-profit sales to employees are also exempted under Mississippi statutes.[39] In addition to stamp machines, North Carolina exempts peanut vending machines and machines vending candy containing 50 percent peanuts.[40] The state of South Dakota broadens its exemptions to include machines vending stamps, drinking cups, sanitary napkins, as well as utility meters.[41] Texas appears to be the only state exempting service vending machines from license or tax. Cigarette vending machines are also exempt, because they are included in the definition of place of business in the cigarette tax.[42] The states of Virginia and West Virginia limit their vending machine exemptions to one commodity. In the former only drinking cup machines,[43] while in the latter only stamp machines[44] are given favored treatment by the legislators.[45]

FARMERS' COOPERATIVES

Unique among unorthodox channels of distribution in having elicited legislative favoritism rather than hostility, cooperatives have already assumed an imposing position as a distributive agency. Over 15,000 farmer-controlled cooperatives are now in operation in this country. Of this number 10,752 are engaged in the marketing of farm products, the purchasing of farm supplies, or the rendering of related services. Data on reported membership and patronage indicate that more than 3,000,000 persons hold membership in these organizations and at least half a

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in dollars of the amount deposited for machines requiring 30 cents or over; N. C. H. B. 610, increasing the state license tax on cigarette vending machines from $5 to $10, on 1 cent food or merchandise machines from 50 cents to $2, and on 5 cent food or merchandise machines from $1 to $4. Inasmuch as the North Carolina proposal continues the grant to local subdivisions of a power to impose a tax not to exceed 50 percent of the state tax, the total potential and likely tax is exactly double the amount of the state exaction.

[37] Ala. Acts 1939, No. 398, amending Ala. Gen. Acts 1935, No. 194, §348, sch. 154.

[38] FLA. COMP. GEN. LAWS (Supp. 1940) §1279(19).

[39] Miss. Laws 1940, c. 122.

[40] N. C. CODE ANN. (Michie, 1939) §7880 (61). [41] S. D. CODE (1939) §57.4101.

[42] TEX. STAT. (Vernon, 1926) art. 7047a-1, amended Tex. Laws 3d Sess. 1936, c. 495, art III, §14.

[43] VA. TAX CODE §198.

[44] W. Va. Laws 1939, c. 119 §10, amending W. VA. CODE ANN. (1937) §916.

[45] While most of the above exemptions have little or no significance from the point of view of governmental favoritism between competitive products, some, like North Carolina's exemption of peanut vending machines, do. *Note on Governmental Product Favoritism, supra* this issue, covers the whole range of this species of marketing barrier. See also text discussion at note 12, *supra*.

million more patronize as non-members. Sales of farm products and farm supplies by American cooperatives exceed $2,000,000,000 annually, with 295 associations reporting sales of more than $1,000,000 each and 34 doing a business in excess of $10,000,000 each.[46]

Marketing and purchasing cooperatives, locally owned, are to be found in every state in the union as well as in the District of Columbia, and Puerto Rico. Through the former, farmers are now marketing a wide variety of products ranging from beef steers to spinach. The purchasing cooperatives engage in the business of supplying farmers with feed, seeds, fertilizer, spray materials, farm machinery, petroleum products, and many other supplies. While most of these products would come under the classification of producers' goods, the farm cooperatives have more recently invaded the consumers' goods field.[47]

In general the marketing cooperative has not been regarded by private distributors as an important competitor. It was rather the purchasing cooperatives because of their closer similarity to retail and wholesale stores, as far as function is concerned, that were considered by retailers as an important competitor in the distributive field. Recently, however, marketing cooperatives also have been so regarded since they have added more and more purchasing services to their activities.

The farmers cooperative movement in the United States has a history of over 130 years. The first period began about 1810 when various cheese-making factories were cooperatively organized at Goshen, Connecticut. About the same time a similar establishment was attempted at South Trenton, New York. In 1857 cooperative grain and livestock associations were formed in several states. A cooperative hog auction was organized in Illinois in 1860, and the first known association for the marketing of fruit was formed in Hammonton, New Jersey, in 1867.[48]

The second period in the history of the cooperatives coincided with the rise of the Grange. As previously mentioned the Grange sponsored cooperatives which would market farm products, buy supplies, and manufacture farm implements. In the opinion of some writers on cooperatives, "the great contribution of the National Grange, however, was the formulation and distribution by its executive committee, in 1875, of a set of rules for the organization of cooperative stores."[49] These efforts ended in failure in most instances. Only a few cooperatives organized at that time have survived and are functioning today.

The great impetus to the growth in the number and importance of the cooper-

[46] *The Statistical Handbook of Farmers Cooperatives,* Farm Credit Adm'n, Coop. Div. Bull. No. 26 (Nov. 1938) 1.

[47] According to the Ohio Farm Bureau News, "Farm Bureau Advisory Councils have been toying for many months with the realization that the average farm family spends more money for household and personal needs—consumers' goods." In response to this suggestion the Farm Bureau Cooperative Association of Columbus, Ohio, late in 1939, started a mail-order service for household goods. To start with, only a few items are to be handled such as blankets, women's hose, men's shirts, and men's working clothing. Gradually other items will be added until the whole range of household supplies will be so distributed. (March 1940) 50 MONTHLY LABOR REV. 665.

[48] Elsworth, *The Story of Farmers Cooperatives,* Farm Credit Adm'n, Circ. E-23 (1940) 1, 2.

[49] *Id.* at 4.

atives came after the World War. Beginning about 1920, and for several years thereafter, large-scale, centralized, cooperative marketing associations were formed for the "orderly marketing" of many agricultural commodities. These centralized cooperatives differ from local associations primarily in that they operate over wider areas, and perform services more extensive in character than can be rendered by a local cooperative. In 1935 there were in operation more than 100 large centralized cooperative associations, with a total membership of about 450,000 farmers.[50]

The present trend in the farmer cooperative movement indicates a shift from the simple, small, independent local enterprise to the large, complex organization. The newer associations go beyond the county shipping point to the large city market. Without doubt the most significant trend appears in the persistent growth in the importance of supply purchasing cooperatives. Whereas 25 years ago purchasing comprised less than 2 percent of the total cooperative business, now it is closer to 15 percent.[51]

What is believed to be the first law recognizing the cooperative method of buying and selling was passed by Michigan. In 1865 it put on its statute books "an act to authorize the formation of mechanics' and laboring men's cooperative associations."[52] It is Massachusetts, though, which is credited with being the first to enact a law, in 1866, which gave full recognition to cooperative buying and selling by farmers.[53] This law contained many of the provisions that are found in present cooperative marketing statutes. Other states soon followed the lead of Massachusetts. Most of the early laws provided only for stock corporations. California in 1895 enacted the first law providing for cooperative non-stock associations.

It was not until the passage of the Clayton Act in 1914,[54] supplementing the Sherman Anti-Trust Act,[55] that Congress officially recognized the existence of non-stock, non-profit farmers' cooperatives. Several prior laws, including the Corporation Tax Law of 1909[56] and the Tariff Act of 1913,[57] exempted from their taxing provisions "labor, agricultural, and horticultural organizations," but failed to mention whether or not these organizations were to be conducted for the mutual help of their members. The Clayton Act clarified the legal status of cooperatives for the first time when it excluded from its anti-trust and restraint of trade provisions "labor, agricultural, and horticultural organizations, instituted for the purpose of mutual help and not having capital stock or conducted for profit." The Capper-Volstead Act of 1922[58] gave legislative sanction for agricultural producers to organize cooperative associations provided that they were operated for the mutual benefit of the members.

The Cooperative Marketing Act of 1926[59] was the first to acknowledge the advantages to the farmer in cooperative purchasing of farm supplies, and to offer

[50] Fetrow, *Cooperative Marketing of Agricultural Products*, Farm Credit Adm'n Bull. No. 3 (1936) 3.
[51] Elsworth, *supra* note 48, at 26.
[52] *Id.* at 2.
[53] *A Study of Farmers' Cooperatives in Virginia* (Am. Retail Fed., 1940) (unpublished manuscript).
[54] 38 STAT. 730, 15 U. S. C. §§12-27; 38 STAT. 738, 29 U. S. C. §52 (1914).
[55] 26 STAT. 209, 15 U. S. C. §§1-7 (1890).
[56] 36 STAT. 112 (1909).
[57] 38 STAT. 114 (1913).
[58] 42 STAT. 388, 7 U. S. C. §§291, 292 (1922).
[59] 44 STAT. 1895, 7 U. S. C. §451 (1926).

federal assistance to the cooperatives. The Secretary of Agriculture was directed to establish a Division of Cooperative Marketing[60] which was (1) to make studies of the economic, legal, financial, social, and other phases of cooperation and to publish its findings; and (2) to promote the knowledge of cooperative principles and practices and to cooperate with educational and marketing agencies and cooperative associations in promoting this knowledge. Judging by the activities and publications of this division there is reason to believe that it does more than any other single government agency to promote and foster farmers' cooperatives.

Another federal act which rendered assistance to the cooperatives was the Agricultural Marketing Act of 1929.[61] The Federal Farm Board was appointed by the President under this act and an appropriation of half a billion dollars was authorized for it as a revolving fund.[62] Among other things this fund was designed to assist cooperatives by making loans available. Several new cooperatives were established soon after the Board was created which otherwise would probably not have been organized; in any event substantial aid in the form of loans from the revolving fund was extended to some of them.

The Farm Credit Act of 1933[63] constituted further favorable legislation for cooperatives in that it authorized the establishment of twelve banks for cooperatives throughout the country, with a Central Bank for Cooperatives in the District of Columbia. Up to this time federal credit aid had been available only for marketing purposes, but under this act the central bank and the regional banks were authorized to make loans to all farmers' cooperatives, including both marketing and purchasing associations. The Farm Credit Act of 1935[64] enlarged the lending powers of banks for cooperatives and amended the Agricultural Marketing Act to include associations furnishing farm business services, such as insurance, power, and transportation.

Although federal legislation plays an important rôle in promoting farmers' cooperatives, it should be noted that most of the laws governing the incorporation, regulation, and taxation of such cooperatives are state enactments. Furthermore, many state laws provide for a Division of Markets in the State Department of Agriculture, one of the duties of which is to assist in the organization of farmers' cooperative marketing and purchasing associations.

Promotive legislation on both the state and federal level has taken four distinct forms: (1) financial aid at comparatively low interest rates; (2) exemption of the earnings of cooperatives from taxation; (3) special advantages in the laws of incorporation; and (4) educational, research, and promotional assistance. In the matter of tax exemptions it is interesting to note that although all types of dividends paid from whatever source by consumers' cooperatives are taxable, the Bureau of Internal Revenue has ruled "that a farm purchasing cooperative which buys groceries

[60] This is now part of the Farm Credit Administration. Under this law was created the present Cooperative Research and Service Division of the Farm Credit Administration.

[61] 46 STAT. 11, 12 U. S. C. §§1141-1141j (1929).

[62] The activities and funds of the Federal Farm Board were transferred to the Farm Credit Administration under Exec. Or. 6084, March 27, 1933.

[63] 48 STAT. 257, 12 U. S. C. A. c. 7 (1933).

[64] 49 STAT. 313, 12 U. S. C. A. c. 7 (1935).

or other consumers' goods for members is exempt from such taxation, provided that purchases for non-members do not exceed 15 percent of the total."[65] Six states, however, exempt consumers' as well as farm cooperatives from taxation on amounts distributed as patronage dividends.[66]

In a number of states cooperatives are exempted from the "blue sky laws." Kansas, for example, expressly saves cooperatives from such regulation.[67] The Federal Securities Act of 1933 also exempts "any security issued by a farmers' cooperative association."[68] In some states there are only limited or partial exemptions. Iowa, for example, exempts issues by cooperatives if the amount is for less than $25,000.[69] Blue sky exemption is no doubt based on the premise that these laws were designed primarily to protect investors, and that the purchase of stock in a cooperative is not truly an investment but rather a normal procedure in the establishment of a business relationship resulting in mutual service.[70]

Despite all the favorable promotive legislation and other forms of government protection, the cooperatives as innovations in the distributive field had to combat the antagonism of established and orthodox agencies. The means employed to curb their growth and influence were diverse, ranging from the spreading of false statements on methods of cooperative operation to boycotts through boards of trade or similar organizations.[71]

Now that farmers' cooperatives are an established phase of our distribution pattern, it is interesting to note the attitude of many of their leaders toward the consumers' cooperatives. "In recent legislative effort to establish credit 'parity' for consumer cooperatives, the voice of organized agriculture turned against it."[72] It appears that owing to the antagonism of farm marketing cooperatives Congress refused in 1937 to grant funds to the Bureau of Agricultural Economics for a study of the possible effect of consumers' cooperative buying operations on farm income and prices.[73]

CONCLUSIONS

The conflicts and frictions between orthodox and newer, more direct, channels of distribution are continuous. Only the forms change; the basic rivalries remain the same. This is bound to be so in a free dynamic society where economic institutions are not ossified. Regardless of legislative restriction or favoritism, in a society where the ultimate consumers are the final arbiters, only those forms of distribution will survive and flourish which perform a function meeting the needs of the people. During the long evolutionary development of the present retailing system, there has gone on a relentless competition that in many instances ruthlessly discarded those forms of distribution found either uneconomical or otherwise without consumer favor. Discriminatory legislation has not stopped the peddler, itin-

[65] BURLEY, *op. cit. supra* note 23, at 267.
[66] The six states are Ariz., Cal., Minn., Mont., N. D. and Wis.
[67] KAN. GEN. STAT. (Corrick, 1935) §17-1224.
[68] 48 STAT. 74, 15 U. S. C. §77 (c) (5) (1933).
[69] IOWA CODE (1939) §§8581-04, 8512-59.
[70] PACKEL, THE LAW OF THE ORGANIZATION AND OPERATION OF COOPERATIVES (1940) 218.
[71] *Id.* at 223-224.
[72] BURLEY, *op. cit. supra* note 23, at 200.
[73] *Ibid.*

erant merchant, department store, mail-order house, or vending machine from finding a niche in our distributive system. Neither has promotive legislation given to the cooperatives a monopoly of the farmers' purchases. Unless our economic order should become a rigidly controlled politico-economic society, it is difficult to assume that present distribution methods will not be challenged by newer types not yet developed.

It is a pity, though, that vested institutions must invoke the aid of legislators in the forty-eight states and the Federal Government. The net result is usually discriminatory legislation not only between types of distributors within the state but also against agents from without the state. The consequence of it all is retaliatory laws causing further marketing barriers. Our present system of distribution is far from perfect. It is a developing process and hence affected by changes in our methods of production, our standards of living, and our concepts of ethics. No agency, therefore, can or should be regarded as the final one which must be preserved to the exclusion of novel methods called forth by new situations.

By and large, courts have been inclined to validate the legislation that has resulted from the appeal for governmental aid. Here, as with other legislative manipulation of the free market, judicial tolerance has been the rule.[74] Recent months, however, have seen certain signs of judicial restiveness under the shackles imposed by the rule of abnegation, signs which perhaps foretell a trend toward court views of yesteryear.[75] Two 1940 decisions seem to be of especial significance. *Good Humor Corp. v. City of Long Beach*[76] invalidated an ordinance directed at ice cream peddlers because it was "... *in restraint of trade,* unreasonable and discriminatory."[77] There is in the making here a conception of a basic communion of spirit between due process and free competition, to the potentialities of which the pages of this journal only recently bore eloquent testimony.[78] A second possible straw in the wind is *N. J. Good Humor, Inc. v. Board of Comm'rs.*[79] Acting on the same philosophy, it invalidated a general prohibition on hawking as a "... subversion of competition ... not in the public interest, and the police power can only be addressed to that end."[80] Were such new coinage to come to enjoy common judicial currency, present intellectual fashions among the state judiciaries would fast lose circulation. Those fashions are not, however, without their devotees; typical is the action of an appellate Ohio court in sustaining a prohibition of ice cream peddlers in the name of little children.[81] In the last analysis, therefore, the solution of the barrier problem must necessarily lie primarily with the people and their elected representatives.

[74] An over-all evaluation of the part the judiciary has played in the barrier problem is to be found in Isaacs, *Barrier Activities and the Courts: A Study in Anti-Competitive Law, infra* this issue.

[75] See *ibid.* [76] 22 N. Y. S. (2d) 382 (1940). [77] *Id.* at 383 (ital. added).

[78] Hamilton, *Common Right, Due Process and Antitrust* (1940) 7 LAW & CONTEMP. PROB. 24.

[79] 124 N. J. L. 162, 11 A. (2d) 113 (1940). [80] 11 A. (2d) at 117.

[81] X-Cel Dairy v. City of Akron, 63 Ohio App. 147, 25 N. E. (2d) 700 (1939). Arnold v. Board of Examiners, 109 P. (2d) 779 (N. M. 1941), although a price-fixing case, is significant for its disposition of the contention that minimum-price fixation was violative of N. M. CONST. Art. IV, §38: ". . . the legislature shall enact laws to prevent trusts, monopolies and combinations in restraint of trade."

LEGISLATIVE OPPOSITION TO CHAIN STORES AND ITS MINIMIZATION

GEORGE J. FELDMAN*

While less direct in their application than other types of legislation, chain store taxes are none the less marketing barriers in the broad sense in which the term is used in this symposium.[1] Their effect—indeed their avowed purpose—is to obstruct one channel of distribution in order to divert the flow of goods into other channels. This article discusses three phases of the subject: first, the history of chain store taxes and their treatment at the hands of the courts; second, other legislation with an anti-chain store "flavor," such as the Robinson-Patman Act, fair trade laws, sales-below-cost laws, and state price discrimination laws; and third, some of the economic effects of the foregoing, including devices used for their minimization.

CHAIN STORE TAXATION[2]

The first tax aimed at chain stores was a city ordinance of Danville, Kentucky, which provided for taxation of cash-and-carry stores at a higher rate than ordinary grocery stores. It was declared unconstitutional by the state courts in 1925 on the ground of improper tax classification.[3] In 1927, Maryland enacted a law levying a tax of $500 per store on all stores in any chain consisting of six or more stores in Allegany County.[4] This was declared unconstitutional the following year[5] in an opinion interesting for its forecast of the development, almost a decade later, of the supermarket. Within the ensuing several years chain store taxes were enacted and declared unconstitutional in Georgia,[6] South Carolina[7] and North Carolina.[8]

* B.A., 1923, Brown University; LL.B., 1926, Boston University. Member, District of Columbia and Massachusetts Bars; member of the firm of Feldman, Kittelle, Campbell & Ewing, Washington, D. C. Formerly attorney for Federal Trade Commission and National Recovery Administration. Co-author, BUSINESS UNDER THE NEW PRICE LAWS (1937); DOES TRADE NEED ANTI-TRUST LAWS? (1931).

[1] Indeed, the Marketing Laws Survey of the Works Progress Administration included chain store tax laws in its *Digest of State Laws Relating to the Problem of Interstate Trade Barriers for States Whose Legislatures Convene in 1940* (Jan. 1940).

[2] For greater detail on various phases of the chain store tax movement, consult Becker and Hess, *The Chain Store License Tax and the Fourteenth Amendment* (1929) 7 N. C. L. REV. 115; Collins, *Anti-Chain Store Legislation* (1939) 24 CORN. L. Q. 198; Brown, *A Note on Federal Taxation of Chain Stores* (1940) 13 J. BUS. UNIV. CHI. 74; Lee, *Recent Trends in Chain-Store Tax Legislation* (1940) 13 *id.* 253.

[3] City of Danville v. Quaker Maid Co., 211 Ky. 677, 278 S. W. 98, 43 A. L. R. 590 (1925).

[4] Md. Laws 1927, c. 554, §§1-3.

[5] Keystone Grocery & Tea Co. v. Huster, Circuit Court of Allegany County, Md., Apr. 21, 1928, Equity 10,922 (unreported).

[6] F. W. Woolworth Co. v. Harrison, 171 Ga. 891, 156 S. E. 904 (1931).

[7] Southern Grocery Stores v. Query, Court of Common Pleas, Richland County, S. C., Feb. 27, 1929 (unreported).

[8] Great A&P Tea Co. v. Doughton, 196 N. C. 145, 144 S. E. 701 (1928). The North Carolina

As can be seen, prior to 1931, chain store taxes were generally considered invalid. In that year, however, the United States Supreme Court handed down its well-known decision in *State Board v. Jackson*,[9] upholding an Indiana tax graduated from $3 on one store to $25 on each store in excess of twenty. Since this leading case precipitated the flood of chain store taxes now on the books of some twenty states, it is worth while to examine it briefly.

The case was tried before a statutory three-judge federal district court which, after hearing voluminous testimony on both sides, concluded that the act was unconstitutional. A direct appeal was taken to the Supreme Court of the United States. It so happened that during the trial of this case in the court below, Federal Equity Rule 70½ was not in effect and the district court made no findings of fact. Ordinarily the Supreme Court would have sent the case back for such findings, but in this instance decided to make its own factual summary. The evidence was conflicting and findings of fact in either direction were possible. The district court, being opposed to the tax, would probably have made findings on which a reversal could have been supported only with difficulty. Without necessarily challenging the ingenuity of the Supreme Court to surmount such an obstacle, the writer believes that had the district court done this, its decision might have been affirmed and the entire chain store tax movement nipped in the bud. As it was, the Supreme Court held that the possession by chain stores as a class of thirteen "advantages" over independent merchants justified their separate treatment for taxation.

Since the *Jackson* case the Supreme Court has on four occasions dealt with anti-chain tax enactments. *Fox v. Standard Oil Co.*[10] concerned the express inclusion of filling stations in a chain store tax ranging from $2 on two stores to $250 per store on more than 75 stores. As in the *Jackson* litigation a finding of invalidity by the lower federal court[11] was reversed on appeal. Twice has the Court dealt with the measure of per-store taxes. *Liggett v. Lee*[12] involved a rate schedule so constructed as to impose heavy additional taxes where the stores were located in more than one county.[13] The Court held the basic tax valid, but declared that classification of rates on the basis of county boundary lines was improper. In doing so, however, it indicated that, if properly set up, a greater tax might validly be levied on national as distinguished from local chains.

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law was later amended so as to provide a tax of $50 on every store in a chain of two or more stores in the state, the former tax applying only if the chain owned six or more stores in the state. As amended, the North Carolina law was declared constitutional in Great A&P Tea Co. v. Maxwell, 199 N. C. 433, 154 S. E. 838 (1930), *aff'd* (after the *Jackson* case, *infra*), 284 U. S. 575 (1931).

[9] 283 U. S. 527 (1931).

[10] 294 U. S. 87 (1935).

[11] Standard Oil Co. v. Fox, 6 F. Supp. 494 (S. D. W. Va. 1934).

[12] 288 U. S. 517 (1933).

[13] This law also imposed a tax of $3.00 on each $1,000 worth of stock carried in chain stores and chain warehouses, as compared with a tax of only $1.50 per $1,000 on stocks of ordinary wholesalers. This discrimination was held valid. Also held valid was a provision in the law permitting counties and cities to impose chain store taxes equal to 25 percent of the state tax. In addition, the exemption of filling stations from this law was held valid on the ground that they constitute a distinct line of business which already pays heavy license and gasoline taxes.

Thus was foreshadowed the Court's later decision in *Great Atlantic & Pacific Tea Co. v. Grosjean,*[14] sustaining the Louisiana provision that the tax, though applied only to stores located within the state, was to be measured by the total number of units in the chain wherever located. In *Stewart Dry Goods Co. v. Lewis*[15] graduated gross receipts taxation of all retail merchants was judicially condemned. The Court's unfavorable view was grounded on the fact that the tax was not confined to a particular *method* of merchandising and was not justified by the proposition that profits increase with sales.[16]

So much for the decisions of the United States Supreme Court. Following their defeat in the *Jackson* case, the chain stores sought on a number of occasions to have chain store taxes declared invalid by state courts under their respective state constitutions. Until rather recently, however, this effort was unsuccessful.[17] In the past two years the chain stores have been more fortunate, and while their success is by no means phenomenal, it may mark a turning point in the attitude of the courts toward chain store tax legislation. In 1939, the courts of two states declared their chain store taxes to be in violation of the state constitution.[18] The first of these cases was *Great Atlantic & Pacific Tea Co. v. Kentucky Tax Commission,*[19] involving a tax graduated from $2 on one store to $300 on each store over fifty. In holding that this tax violated the state constitution the court stated that the statute could not be upheld as a police measure because on its face it was for revenue purposes.

[14] 301 U. S. 412 (1937).

[15] 294 U. S. 550 (1935).

[16] The decision in the *Stewart Dry Goods* case was followed in: Tollerton & Warfield Co. v. State Board, 222 Iowa 908, 270 N. W. 427 (1936); State *ex rel.* Lane Drug Stores v. Simpson, 122 Fla. 637, 166 So. 227 (1936); State *ex rel.* Adams v. Lee, 166 So. 249 (Fla. 1936); Safeway Stores v. Vigil, 40 N. M. 190, 57 P. (2d) 287 (1936); Schuster & Co. v. Henry, 218 Wis. 506, 261 N. W. 20 (1935), *cert. denied,* 296 U. S. 625 (1935); Great A&P Tea Co. v. Harvey, 177 Atl. 423 (Vt. 1935); Great A&P Tea Co. v. Valentine, 12 F. Supp. 760 (S. D. Iowa 1935), *aff'd,* 299 U. S. 32 (1936). In National Tea Co. v. Minnesota, 205 Minn. 443, 286 N. W. 360 (1939), the Supreme Court of Minnesota declared the graduated gross receipts tax of that state unconstitutional. The Supreme Court of the United States, on *certiorari,* uncertain whether the decision in the state supreme court was based on the state or federal constitution, sent the case back for clarification of this point. 309 U. S. 551 (1940). The state supreme court on Sept. 27, 1940, reconsidered the case and handed down an opinion stating categorically that the tax violated the uniformity clause of the *state* constitution.

[17] Chain store taxes were declared valid in the following cases: Shyer's, Inc. v. Butler, Circuit Court of Montgomery County, Ala., July 25, 1933 (unreported); J. C. Penney Co. v. Diefendorf, 54 Idaho 374, 32 P. (2d) 784 (1934); C. F. Smith Co. v. Fitzgerald, 270 Mich. 659, 259 N. W. 352 (1935); Hurt v. Cooper, 130 Texas 433, 110 S. W. (2d) 896 (1937). In addition the chain store tax in South Carolina was held valid by a federal district court in Southern Grocery Stores, Inc. v. Tax Commission, 55 F. (2d) 931 (E. D. S. C. 1932); and a Mississippi statute levying a gross receipts tax of ¼ of 1 percent on retailers and chains of five stores or less, with an additional ¼ of 1 percent on chains of more than five stores, was held valid in Penney Stores v. Mitchell, 59 F. (2d) 789 (S. D. Miss. 1932), *appeal dismissed,* 287 U. S. 672 (1932).

[18] Chain store tax laws of two other states were also invalidated in 1939 for technical defects in their enactment: Vaughn & Ragsdale, Inc. v. State Board, 109 Mont. 52, 96 P. (2d) 420 (1939) (defective enacting clause); C. Thomas Stores Sales System, Inc. v. Boyle, District Court, 4th Judicial District, Hennepin County, Minnesota, Sept. 26, 1939 (unreported) (embracing more than one subject; also certain exemptions held discriminatory). A chain store tax in South Dakota was invalidated in 1936 because the bill did not receive the required two-thirds majority vote in the legislature. Barnsdall Refining Co. v. Welsh, 64 S. D. 647, 269 N. W. 853 (1936). These, however, were merely temporary successes on the part of the chains which postponed, but did not eliminate, chain store taxes from the states concerned.

[19] 278 Ky. 367, 128 S. W. (2d) 581 (1939).

It indicated, however, that if a business needed regulating under the police power, it should be regulated and not taxed out of existence. The state constitution was held to require that classifications of persons for tax purposes be made on a natural and reasonable basis, and the classification of chain stores was found not to fall in that category.

The Kentucky court reviewed the cases in which chain store taxes had been upheld, as well as those prior to the *Jackson* case in which they had been invalidated. It stated that most of the cases sustaining these taxes had construed the uniformity provision of the state constitution as applicable only to *ad valorem* taxes on property, and not to license fees; and, further, that the statutes in these cases were enacted under the police power and not purely as revenue measures. The court pointed out that the cases upholding chain store taxes indicated that it was constitutional to discourage or even destroy chain stores. The constitution of Kentucky, however, had never been so construed, but on the contrary forbade license taxes which confiscated property or suppressed legitimate occupations. The court specifically found that the thirteen "advantages" of chain stores enumerated in the *Jackson* case were not peculiar to the chains as a class.

The second case in which a chain store tax was invalidated in 1939 was *American Stores Co. v. Boardman*.[20] This case involved a Pennsylvania statute levying a tax graduated from $1 on one store or theater to $500 on each store or theater in excess of five hundred. The decision of the state supreme court was based entirely upon one ground, namely, that the constitution of Pennsylvania does not permit graduated taxation, but requires that *all taxes* be uniform.

Although the state supreme court did not mention the *Jackson* case, the lower court devoted considerable attention to this and other chain tax decisions. It pointed out that the decisions of the United States Supreme Court on the subject were closely divided: two of them 5-4, two 6-3 and one 4-3. This court held it immaterial that graduated chain store taxes existed in twenty-one states and that a majority of them had been held constitutional. Declaring that voluntary chains operate in the same way, the court stated that the evidence before it did not bear out the conclusions arrived at by the United States Supreme Court in the *Jackson* case on the "advantages" of corporate chain stores. Moreover, it held that it was not justified in saying, as the United States Supreme Court did in the *Grosjean* case, that a tax may increase in proportion to the number of stores since the opportunities and powers of a chain become greater with size.[21]

In addition to state chain store tax statutes, the chains have also been burdened at times with various types of discriminatory municipal ordinances. Their attacks on these in the courts have, on the whole, been somewhat more successful than

[20] 336 Pa. 36, 6 Atl. (2d) 826 (1939).

[21] In addition to the foregoing cases, an amendment to the Tennessee chain store tax providing that out-of-state corporations must pay one and one-half times the tax paid by domestic corporations, was held void. Great A&P Tea Co. v. McCanless, Tenn. Chancery Court, Pt. II, Tenn., July 14, 1939 (unreported).

their attacks on state legislation. As stated earlier, a discriminatory tax levied by the City of Danville, Kentucky, against cash and carry stores was invalidated in 1925.[22] A similar ordinance of the City of Douglas, Georgia, was invalidated in 1935.[23] Chain store tax ordinances of the graduated "per store" type enacted by the cities of Hamtramck, Michigan, St. Louis, Missouri, and Columbus and Augusta, Georgia, were also declared invalid.[24] The score for the chains has not been perfect, however, for chain store tax ordinances have been held valid by the Supreme Courts of Oregon, Virginia and South Carolina.[25]

Brief mention should be made of the status of chain store tax laws today,[26] and also of the Federal chain store tax proposed by Congressman Patman of Texas. Chain store tax laws are now on the books of twenty states.[27] Of these, only four are of the so-called "Louisiana" type in which the tax on stores within the state is based upon the number of stores both within and without the state.[28] The remaining sixteen are of the regular, or "Indiana," type, with the exception of the Tennessee statute which is based on floor space.

The Patman Bill, first introduced in 1938 as H. R. 9464, was re-introduced in 1939 as H. R. 1. It has maintained this designation through successive re-introductions ever since. The bill originally provided for a graduated chain store tax ranging from $50 per store on chains of less than 10 units up to $1,000 per store on chains of more than 500 units, and provided that the foregoing rates should be multiplied by the number of states (including the District of Columbia) in which the chain operated. At the time of the hearings, in the spring of 1940, the bill was revised by cutting the tax in half in each bracket and by providing that the tax did not apply to chains of 50 stores or less operated in and from a single state or within a radius of 100 miles of a single city. The revised bill also provided that for seven years after the effective date of the act the multiplication of the tax by the number of states in which the chain operated would not apply so long as the chain did not increase the number or change the location of its outlets. In addition, Mr. Patman proposed an amendment striking out the exemption of filling stations and making them subject to the tax.[29]

[22] City of Danville v. Quaker Maid Co., *supra* note 3.

[23] City of Douglas v. South Georgia Grocery Co., 179 S. E. 768 (Ga. 1935).

[24] Kroger Grocery & Baking Co. v. City of Hamtramck, Circuit Court for the County of Wayne, Mich., Dec. 23, 1932 (unreported); Kroger Grocery & Baking Co. v. St. Louis, 341 Mo. 62, 106 S. W. (2d) 435 (1937); Great A&P Tea Co. v. City of Columbus, 189 Ga. 458, 6 S. E. (2d) 320 (1939); Southern Grocery Co. v. City of Augusta, 189 Ga. 618, 7 S. E. (2d) 181 (1940); Great A&P Tea Co. v. City of Columbus, Muscogee Superior Court, Aug. 27, 1940 (unreported).

[25] Safeway Stores, Inc. v. City of Portland, 149 Ore. 581, 42 P. (2d) 162 (1935); City of Fredericksburg v. Sanitary Grocery Co., 168 Va. 57, 190 S. E. 318 (1937); Great A&P Tea Co. v. Spartanburg, 170 S. C. 262, 170 S. E. 273 (1933).

[26] As of December 1940. No new chain store taxes were, to the writer's knowledge, enacted during the first six weeks of 1941, although legislatures of forty-three states have been in session.

[27] Ala., Colo., Fla., Ga., Idaho, Ind., Iowa, Ky., La., Md., Mich., Minn., Miss., Mont., N. C., S. C., S. D., Tenn., Tex. and W. Va. The chain store tax of Wisconsin expired on July 1, 1940, by its own terms, and has not been re-enacted. The Kentucky statute was passed in 1940, notwithstanding the invalidation in 1939 of the prior law, for which see note 19, *supra*. [28] Ky., La., Miss. and S. D.

[29] *Hearings Before the Subcommittee of the Senate Committee on Ways and Means on H. R. 1*, 76th Cong., 3d Sess. (1940) 5.

Despite the reduction of the proposed tax by half, it was obvious that its purpose and effect was still to drive out of existence chains operating in more than one state. The Great Atlantic and Pacific Tea Company with approximately 9,000 stores located in 39 states would have to pay a tax under the original bill of over $300,000,000 per year, yet its total sales in 1938 were only $881,703,076 and its net profits $9,119,114.[30] The tax under the original bill was over 30 percent of the Atlantic & Pacific Tea Company's total sales and nearly 33 times its net profits. Cutting the tax rate in half had about the same practical effect as reducing the prison sentence of a convict from 998 years to 499 years.

The seven-year moratorium on the multiplication feature of the tax was also of little benefit to large chains, for in order to avail themselves of it they had to refrain from adding any new stores or moving the locations of any existing stores. This prevention of natural expansion, and of such re-location as would be necessary to keep pace with the shifts of local business, amounted to slow strangulation.[31]

ANTI-CHAIN STORE "FLAVOR" OF OTHER LEGISLATION

Space does not permit more than brief consideration of such less direct anti-chain store legislation as the Robinson-Patman Act, state fair trade laws, sales-below-cost laws and state anti-discrimination laws.[32]

The Robinson-Patman Act[33] was enacted in 1936 largely at the behest of organized wholesale grocers and food brokers. In essential purpose it was an anti-chain store measure, designed to deprive the chains of purchasing advantages which the proponents of the act believed they had been getting. Briefly, the law provides that discriminations between purchasers are lawful only if justified by differences in the cost of manufacturing, selling, and delivering the goods to such purchasers. In addition, it prohibits the payment of brokerage in any form by a seller to a buyer under any circumstances.[34] The act also prohibits a seller from giving a buyer any services or facilities, or any payment for services performed by the buyer, unless made available to all buyers on proportionately equal terms. A buyer who know-

[30] *Id.* at 153.

[31] H. R. 1, 77th Cong., 1st Sess., as reintroduced in 1941, provides for a tax graduated from $25 on chains of 15 stores or less up to $500 on each store in excess of 500, the foregoing rates to be cut in half during the fiscal year following date of enactment, and to be cut one-fourth during the second such fiscal year. The multiplication of the tax by the number of states in which the chain operates is applicable only against such stores as are physically located in premises not occupied by a store of that chain on the effective date of the act (unless such premises were abandoned and later re-occupied by the same chain). It is provided that none of the provisions of the bill (including the basic tax as well as the multiplied tax) shall apply to chains of 50 stores or less located in and operated from a single state or within a radius of 100 miles of a single city, nor to any chain with a gross business of $250,000 or less per annum.

[32] These laws formed the subject of an earlier symposium in this journal, *Price Discrimination and Price Cutting* (1937) 4 LAW & CONTEMP. PROB. 271 *et seq.*

[33] 49 STAT. 1528, 15 U. S. C. A. §13 (1936).

[34] Literally, the act permits the payment of such brokerage for "services rendered," but the courts have held that buyers cannot render services to sellers as a matter of law. Great A&P Tea Co. v. Federal Trade Commission, 106 F. (2d) 667 (C. C. A. 3d, 1939), *cert. denied,* 308 U. S. 625 (1940).

ingly induces or receives a discrimination prohibited by the act is equally liable with the seller.[35]

Fair trade laws are found on the books of forty-four states.[36] They provide in substance that a manufacturer may enter into contracts with his wholesale or retail dealers establishing the prices at which the latter are to resell the manufacturer's trademarked or branded merchandise. A contract with a wholesaler may also provide that when the wholesaler resells to a retailer he will require the retailer to enter into a similar contract. Such contracts are expressly exempt from the state anti-trust laws.[37] The fair trade laws also provide that whenever any such resale price contracts are in effect with respect to a manufacturer's product no person, whether a party to the contract or not, shall wilfully and knowingly advertise, offer or sell that product at less than the contract price. Thus by entering into a contract with a single dealer, and sending notices of it to all other dealers, a manufacturer can effectively peg resale prices on his product throughout the entire state. These laws have been held constitutional by the United States Supreme Court.[38]

So-called sales-below-cost laws are found on the books of twenty-six states.[39] These laws vary considerably in detail, but in general prohibit retailers and wholesalers[40] from selling at less than invoice or replacement cost (whichever is lower) plus the cost of doing business. Some of these laws define "cost of doing business" in very broad terms, and state that cost surveys made with respect to a particular trade in a particular locality shall be deemed competent (or *prima facie*) evidence of such cost. Others establish a specific percentage mark-up (frequently 6% for retailers and 2% for wholesalers) as the "cost of doing business." The mark-up applies only in cases where the wholesaler or retailer cannot prove a lower cost of doing business. Virtually all of these laws prohibit sales below cost only when made with the intent or effect of injuring competitors or destroying competition. They do not apply in certain enumerated cases, such as sales of perishable articles to forestall loss, sales of discontinued lines, sales under court order, sales to meet a competitor's price, and the like.

State anti-price discrimination laws are found on the books of twenty-five states,

[35] Other provisions of the act are: (a) A criminal provision prohibiting price discrimination, locality price discrimination, and sales at "unreasonably low prices," which has never been enforced. (b) A provision dealing with litigation pending under the original Section 2 of the Clayton Act at the time the Robinson-Patman Act was passed. (c) A provision exempting from the act the payment of patronage dividends by co-operatives to their members. (d) An amendment providing that the act does not apply to purchases by schools, colleges, universities, public libraries, churches, hospitals and charitable institutions not operated for profit.

[36] All states except Del., Mo., Tex. and Vt.

[37] The Tydings-Miller Act, 50 STAT. 693, 15 U. S. C. A. §1 (1937), grants a similar exemption from the Sherman Act with respect to resale price maintenance contracts on goods which are to be resold in a state where such contracts are made lawful by any statute, law or public policy. This removes the danger of entering into Fair Trade contracts in connection with interstate commerce. Previously such contracts violated the Sherman Act. Dr. Miles Medical Co. v. Parks, 220 U. S. 373 (1911).

[38] Seagram Distillers Corp. v. Old Dearborn Distributing Co., 299 U. S. 183 (1936).

[39] Ariz., Ark., Cal., Colo., Conn., Idaho, Ky., La., Me., Md., Mass., Mich., Minn., Mont., N. J., Ore., Pa., R. I., S. C., Tenn., Utah, Va., Wash., W. Va., Wis., Wyo.

[40] A few of them also prohibit sales below cost by manufacturers.

often in combination with a sales-below-cost law.[41] These laws fall into two classes. Those in three states are patterned upon the Federal Robinson-Patman Act.[42] The rest merely prohibit the sale of goods by a person at one place in the state at a lower price than in another place for the purpose of injuring competitors or destroying competition. The origin of some of these laws goes back to the early part of this century. Their original purpose was to prevent a monopolistic practice prevalent at that time in which a large combination, seeking to gain control of the market, cut prices in one locality until its competitors were driven out of business, meanwhile maintaining higher prices in localities where no competition existed.

The attempt to apply these laws to chain stores is of recent origin and thus far has not fared well at the hands of the courts.[43] It has generally been demonstrated that where a chain sells at different prices in its different stores, it does so not for the purpose of injuring competition or creating monopoly, but for the purpose of meeting local competitive conditions or of reflecting differences in the cost of operations at different store locations.

ECONOMIC EFFECTS AND MINIMIZATION OF ANTI-CHAIN LEGISLATION

It is impossible to discover with precision the effects of any of the foregoing laws, including chain store taxes, upon the economy. The writer is not aware of any statistical surveys showing whether or not chain store taxes have caused a direct price increase to consumers. That their *purpose* lies in this direction cannot be questioned, but it is not at all clear that this purpose has been fulfilled.

Although a chain may decide to absorb the tax and take a smaller net profit, the burden of the tax may cause it to curtail existing or proposed operations which would otherwise be profitable and, by cutting down total volume, increase costs of operation. It is undoubtedly true that chain store executives have refrained from opening stores that would have been opened had there been no chain store tax. This is particularly true of experimental stores opened in growing neighborhoods to take advantage of a good location before the business in the neighborhood actually reaches its full growth. It was quite a common practice in the past to open such stores and to operate them, not at a loss, but at a lower rate of profit than was ultimately to be expected. This practice has undoubtedly been cut down severely by the existence of chain store taxes.

On the other hand, it cannot be said that all chains have suffered a loss of volume with consequent higher operating costs as a result of chain store taxes. The development of the supermarket has in large measure prevented this. Where a chain has gone into the supermarket type of operation on a sizeable scale, it is the writer's opinion that chain store taxes have not produced an increase in prices. And it is

[41] The following states have anti-discrimination but not sales-below-cost laws: Fla., Iowa, Kan., Miss., Mo., Neb., N. D., Okla., S. D. The following states have sales-below-cost laws but not anti-discrimination laws: Ariz., Conn., Me., Md., N. J., Pa., R. I., Tenn., Va. and W. Va. All of the other states listed in note 39, *supra*, have both types of laws.

[42] Idaho, Ore., Utah.

[43] Great A&P Tea Co. v. Ervin, 23 F. Supp. 70 (D. Minn. 1938).

doubtful whether chains that have not entered the supermarket field have been able to increase prices either, in view of the necessity of meeting competition. On the whole, therefore, it is probable that the effect of the taxes on chains in the latter category has been to reduce profits.

In this connection, two tendencies in the evolution of chain store taxes since the *Jackson* case should be noticed. First, the amount of the tax in the higher brackets has been greatly increased. The original Indiana law levied a maximum tax of only $25 per store. Recent statutes have levied high tax rates, in Texas $750 per store in the top bracket, and a number of municipal chain store taxes in Georgia were graduated as high as $1,200 per store.[44] Secondly, the tax brackets have been progressively narrowed until the higher taxes fall upon smaller and smaller chains. Earlier laws levied their maximum rates only upon chains of several hundred stores, but a large number of the more recent statutes place extremely heavy taxes on purely local chains of as little as 20 stores. The Texas tax of $750 per store applies to chains of 51 stores and over. It may well be questioned how far these two tendencies will run before reaction sets in. The decisions of the United States Supreme Court indicate that the Federal Constitution would not forbid a tax so heavy as to drive chains out of business entirely,[45] but it seems doubtful that state legislatures will be willing to go that far. As heavier and heavier taxes are applied, particularly in the lower brackets, political repercussions will be heard. Taxes of this type discourage even the progressive local merchant from expanding his business.

While it might at first appear that taxes on very large chains could be increased to confiscatory levels without political hazard, the psychology of the purchasing public must be kept in view. The average housewife has a two-cell mind on the chain store question. She may swallow a good deal of anti-chain propaganda as an academic matter, but she will continue to buy her groceries at the chain store because of its lower prices. To date, she has been able to view chain store taxes with apathy, for she has yet to encounter or realize any substantial effects upon her buying habits. If the chains should begin to disappear from the community, however, theories would very likely be rejected in favor of the compelling requirements of the home budget, and a broad change in public feeling might well take place. Such an awakening would be quickened and enhanced by the rather recent activities of the chains in presenting their side of the case to the consumer. For years these organizations did little or nothing to counteract the flood of propaganda against them, hoping perhaps that economic virtue would triumph unaided. They have realized, however, that pressure groups thrive on public apathy, and that an aroused consumer is their best safeguard.

Pressure groups that are too successful usually end by going too far and destroying all that they have accomplished. The anti-chain store campaign seems well along this road. In an attempt to extend their gains, the wholesale and retail

[44] These, however, were declared unreasonable and invalid. See note 24, *supra*.

[45] "When the power to tax exists, the extent of the burden is a matter for the discretion of the lawmakers." Fox v. Standard Oil Co., *supra* note 10, at 99.

merchants who are behind the movement are alienating many of their own number —persons who formerly backed, or at least did not oppose, chain store legislation. Illustrative of this tendency is a bill introduced this year in the legislature of South Dakota levying a license tax of $10 on separate grocery stores or butcher shops, but a tax of $1,000 on stores selling both groceries and meats in combination.[46] More important, however, has been the gradual encroachment of chain store taxes upon voluntary chains. These chains are nothing more than groups of independent merchants, each owning his own store but banded together for the purpose of co-operative buying, joint advertising, uniform store fronts and methods of merchandising, and greater efficiency. The voluntary chain is the progressive independent merchant's answer to chain store competition.

Voluntary chains fall into two classes: first, retailer-owned co-operatives in which the retail members of the organization own their central warehouse; and, second, wholesaler-sponsored organizations in which the retailers enter into an arrangement with an existing wholesaler to purchase supplies through him on a co-operative basis and to follow common merchandising methods. Although, to the writer's knowledge, chain store taxes have not yet been applied to any of the large well-known voluntary or co-operative chains, the time when this will be done is fast approaching. The courts have already held these taxes applicable to organizations very similar in their characteristics.

In *Bedford v. Gamble-Skogmo, Inc.*[47] the question was raised whether so-called agency stores for the sale of automobile accessories were controlled by the company under whose auspices they were set up. The Gamble-Skogmo Company operated under its direct ownership a chain of automobile accessory stores which it conceded to be subject to the tax. It contested the application of the tax, however, to a group of independently owned stores which were operated under contract with it. These stores were colored and maintained in the same uniform style as the company's own stores. They used advertising furnished by the company. The company suggested their methods of bookkeeping, accounting, and sales and credit operations. The stores sold the goods of the company almost exclusively, and replaced defective merchandise of the company whether sold by them or some other agency or company store. The arrangement between the company and the agency was cancellable by either party on thirty days' notice, at which time the company had an option to buy up the merchandise and fixtures and take over the lease on the agent's location.

The Colorado court held that the object of this arrangement was to reap the advantages of chain store operation without assuming its burdens, and held that

[46] S. D. H. B. 122, 1941. For analysis of legislation of this character consult Cook, *Legislative Restrictions on Marketing Integration;* Edwards, *Economic Implications of Business Boundary Laws,* both *supra* this issue.

[47] 105 Colo. 424, 91 P. (2d) 475 (1939). See also a similar case in which the same decision was reached under the Idaho chain store tax. Idaho v. Gamble-Skogmo, Inc., Dist. Court, 3rd Judicial District, County of Ada, June 12, 1940 (unreported). But *cf.* Ford Motor Company v. Armstrong, Colo. Dist. Court, City and County of Denver, Feb. 9, 1940 (unreported) in which it was held that Ford dealers were not "controlled" by the Ford Motor Company and hence not subject to the chain store tax.

the agency stores were "controlled" by the company and hence subject to the chain store tax. In passing, the court distinguished this agency arrangement from a voluntary co-operative chain by pointing out the absence of mutuality and of joint control by the members of the group. However, it seems to the writer that the arrangement between Gamble-Skogmo, Inc., and its agency stores was practically identical with the arrangement commonly found in a wholesaler-sponsored voluntary chain in the grocery field, and that on the basis of this decision such voluntaries could be subjected to chain store taxes.

Of significance also is *Belk Bros. v. Maxwell.*[48] This case concerned 46 stores, each of which was a separate corporation. None of the corporations owned stock in any of the others. The plaintiff (Belk) owned some, but less than a majority, of the stock in each corporation. He participated in the organization of all of them, and was the president and a member of the board of directors of each. The other directors were not interlocking in any respect. The stores all operated under the name of Belk. Their accounts were audited by the plaintiff at their expense, and they maintained a joint buying office in New York. The North Carolina court held that this group of stores constituted a chain within the meaning of the act and that they possessed the thirteen "advantages" of chain stores, enumerated in the *Jackson* case. The court further held that the application of the tax to this type of operation did not render it unconstitutional, stating that while the Supreme Court had pointed out the distinction between voluntary and corporate chains in *Liggett v. Lee,*[49] it had not held that taxation of the former would be improper.[50]

It may well be wondered whether the proponents of chain store legislation will be able to maintain their political strength and effectiveness if they alienate so large and powerful a group of strictly local independent merchants as the voluntary chains. Mr. Hector Lazo, head of the National Retailer Owned Grocers' Association, a national organization of co-operative chains, not long ago said: "A law passed today to put your competitor out of business may whack you between the eyes tomorrow."[51]

The minimization of chain store taxation through various devices designed to place the chain outside the scope of the law has been only partially successful. A typical device was the lease-and-license arrangement under which major oil companies established filling stations. By this arrangement, which is generally referred to as the "Iowa Plan," the oil company, either owning or leasing the filling station property, leased or sub-let it to an independent operator and entered into a contract with him to market the oil company's products. The details of the various contracts differed in individual cases, sometimes rather widely, and space does not permit discussing them. Suffice it to say that of six cases on the subject, only one held that the independent leased stations were not subject to the tax,[52] while five held that they were subject to the tax.[53]

[48] 215 N. C. 10, 200 S. E. 915 (1939).
[49] *Supra* note 12.
[50] See also Southern States Fredericksburg Service v. Fredericksburg, Corporation Court of the City of Fredericksburg, Va., Aug. 6, 1940 (unreported).
[51] Chicago Daily News, June 22, 1939.
[52] Standard Oil Co. v. Green, 34 F. Supp. 30 (S. D. Iowa 1940).
[53] Standard Oil Co. v. Texas, 142 S. W. (2d) 519 (Tex. Civ. App. 1940); Standard Oil Co. v. State

In addition to attempting to eliminate their leased stations from the tax, a number of the oil companies tried to show that filling stations were not "stores" within the meaning of chain store tax statutes. This contention, if upheld, would have eliminated from the tax not only the leased stations but the company-owned stations as well. However, in only one case, to the writer's knowledge, was the contention of the oil companies upheld.[54] In three cases, filling stations were definitely held to be "stores" within the meaning of the statutes.[55]

Insofar as ordinary chains are concerned, the only significant attempt made to minimize chain store taxes was by cutting down on the number of stores. This was accompanied by a tendency to replace the closed stores with units doing a large volume of business. Thus, chain store taxes are, in part at least, responsible for the development of the supermarket. It is doubtful, however, that chain store taxes were the sole cause of this development. On the contrary, it is generally conceded that the first supermarkets were independent stores. One writer claims that the supermarket was born in Los Angeles, California, as early as 1925 in the form of "drive-in-markets," which were simply parking spaces with a row of small stores and restaurants. The idea did not work, but out of it came the principle of the supermarket which commenced its growth in 1929. According to this writer, the first Eastern supermarket was opened in a garage on Long Island in August, 1930. The famous Big Bear was opened in a vacant automobile plant in Elizabeth, N. J., in 1932.[56]

These were all independent stores and were set up at a time when the chains were still operating on a small neighborhood service store basis. The competition from the supers was keen and eventually the chains would have had to meet it regardless of chain store taxes. That the increased pressure of these taxes spurred the movement along cannot be questioned, and it is probably true that some chain store companies entered the supermarket field solely for the purpose of minimizing their tax burden. It is generally conceded by now, however, that the supermarket has proved so efficient and profitable a method of merchandising that it would undoubtedly remain even if all chain store taxes were repealed.

The sponsors of anti-chain legislation, seeing in the supermarket a new menace to their existence, have made sporadic attempts at legislation against this type of store. They were successful in having ordinances enacted in several cities in New Jersey levying a tax of $200 on every concession or department rented, leased or operated, in any market in which food is sold. These taxes have been upheld by the courts.[57] However, taxes of this kind apply only to a special type of market in

Board, 99 P. (2d) 229 (Mont. 1940); Maxwell v. Shell Eastern Petroleum Co., Inc., 90 F. (2d) 39 (C. C. A. 4th, 1937); Gulf Refining Co. v. Fox, 297 U. S. 381 (1936); Mid-Western Petroleum Corp. v. State Board, 206 Ind. 688, 187 N. E. 882 (1933).

[54] Wadhams Oil Co. v. State, 210 Wis. 448, 245 N. W. 646 (1932).

[55] Fox v. Standard Oil Co., *supra* note 10; Fox v. Gulf Refining Co., 295 U. S. 75 (1935); Mid-Western Petroleum Corp. v. State Board, *supra* note 53.

[56] Davidson, *What About Supermarkets?* (Sept. 17, 1938) 211 SAT. EVE. POST 23.

[57] Giant Tiger Corp. v. City of Camden, 122 N. J. L. 240, 4 A. (2d) 775 (1939); American

which the owner operates only the grocery department and leases out concessions in which all kinds of merchandise are sold. These are really department stores of a unique type and quite different from the exclusive grocery supermarket operated by chain store companies.

An attempt to legislate against the latter type of market has been made in Camden, Atlantic City, and several other communities in New Jersey. Ordinances were passed levying a tax as high as $10,000 per year on any store operated on a self-service basis. The type of store covered by the ordinance was defined in considerable detail, specific mention being made even of the baskets used in accumulating merchandise prior to checking it out and paying for it. However, these ordinances have been declared unconstitutional in the case of *Great Atlantic & Pacific Tea Co. v. Camden.*[58] The court found that self-service methods of merchandising had long been in vogue and that fundamentally, except for the use of baskets, there was no difference between the stores subject to the tax and those not subject to it. A tax of $10,000 a year for the use of so common an article as a market basket was held to be unreasonable.

A brief word about the economic effects of the Robinson-Patman Act and sales-below-cost laws will conclude this article.[59] The Robinson-Patman Act has unquestionably eliminated some of the purchasing advantages of large buying organizations, but it has by no means eliminated them all. As pointed out, the act permits price differentials reflecting savings in the cost of manufacturing and in selling the goods to particular buyers, and there is considerable doubt in the writer's mind whether the price differentials enjoyed by chains were ever in excess of these savings in the long run. In the practical application of the Robinson-Patman Act it is frequently possible for small wholesalers to obtain larger discounts than chain stores, chiefly because of the fact that small companies are less likely to be attacked by the Federal Trade Commission than are larger ones. This is not intended as a reflection on the Commission's policy of enforcement, which the writer knows to be completely fair. But the Commission cannot in the nature of things uncover all of the sporadic instances of price discrimination that may occur throughout the country. It simply does not have a large enough staff of investigators. The big chain, being in the limelight, cannot run the risk of violation, while the little wholesaler can afford to take a chance.

The Robinson-Patman Act has definitely eliminated the practice of paying brokerage to buyers, at least insofar as the corporate chains are concerned. Cases are still pending against some of the large voluntary chain organizations to force them also to discontinue the acceptance of brokerage. The brokerage section of the

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Grocery Co. v. New Brunswick, 124 N. J. L. 293, 11 A. (2d) 599 (1940); Giant Tiger Corp. v. Trenton, 113 N. J. L. 34, 172 Atl. 565 (1934).

[58] 122 N. J. L. 47, 4 A. (2d) 16 (1939).

[59] It would be beyond the scope of this article to discuss the economic effect of the fair trade laws. The subject is discussed rather thoroughly in a memorandum recently issued by the Department of Justice advocating the repeal of the Tydings-Miller Act (Feb. 10, 1941). In view of the fact that the state anti-discrimination laws have been largely ineffective, there is little need for discussion of their operation.

act has proved, however, a boomerang against the very group that sponsored it. As interpreted by the courts, this section prohibits any buyer from accepting brokerage. It has been a common practice of ordinary brokers to purchase an occasional car of merchandise on their own accounts for resale to their customers, but when they do this they cease to be brokers on that transaction and become buyers. The Federal Trade Commission has issued a large number of complaints and cease and desist orders against the practice of brokers purchasing on their own accounts and receiving commissions. Obviously, without such commissions, the broker cannot resell the merchandise at a profit and will, therefore, be forced to abandon this phase of his business. If this is a bad bed, however, it is one of his own making.

State sales-below-cost laws, if set up on a reasonable basis and not abused, have no discernibly harmful economic effects in the opinion of this writer. They have not generally been opposed by the chain stores, since the majority of chains disapprove of loss-leader selling and do not engage in the practice.[60] The trouble with state sales-below-cost laws has been the tendency of organized groups to misuse them by attempting, under their guise, to fix prices at levels having nothing to do with cost. Such abuses are most frequent where the law establishes no statutory mark-up above the cost of the goods, but permits "cost surveys" to be introduced as *prima facie* evidence of the cost of doing business. Cost surveys have been conducted in some states in a most informal manner, frequently by a mere vote of an interested group as to what the cost should be. In some states the "cost" established by these surveys has been raised progressively year by year until it has reached decidedly uneconomic levels. The Department of Justice recently secured indictments against a group of wholesalers and retailers in the State of Colorado for allegedly thus misusing that state's sales-below-cost law,[61] and investigations with an eye to similar indictments are now under way in a number of other states. If and when the abuses of the sales-below-cost acts are eliminated, and the laws themselves written on a reasonable basis with a mark-up that will not penalize the consumer, these laws should, on the whole, be beneficial in their effects.

CONCLUSIONS

In the writer's opinion, the events of the past few years indicate that the anti-chain store forces have pressed their advantage too far. Already a reaction has set in in the thinking of the courts; the public is beginning to get less of a one-sided picture; the abuses of legislation obtained by the anti-chain forces have come under attack by the Department of Justice; and the Federal Government as a whole has become aroused over the multiplication of interstate and other forms of marketing barriers. In the face of this, it seems inevitable that a reaction will ultimately take place in the state legislatures and result in the elimination of a great deal of the chain store legislation now on the books.

[60] *Hearings, supra* note 29, at 741-747.

[61] Department of Justice press release, Jan. 29, 1941.

AN EVALUATION OF LARGE-SCALE RETAILING WITH EMPHASIS ON THE CHAIN STORE

Charles F. Phillips*

Some Reasons for Large-Scale Retailing

Retailing has become increasingly large-scale[1] for reasons similar to those explaining the development of large-scale manufacturing.[2] First, certain factors make it possible for the larger retailer to undersell smaller retailers. Second, the larger retailers have brought about improvements in retailing practices from the consumer's point of view. Third, large-scale retailing has been profitable, thus attracting capital and management.

Ability to Undersell: Economies

The ability of the large-scale retailer to undersell competitors arises from the economies which he has been able to effect, his willingness to accept a relatively low profit margin per dollar of sales, and—except in the case of the department store—his ability to limit "free" services and still attract customers. While by no means all the economies of large-scale retailing can be considered here, an understanding of a few of them is essential to an evaluation of large retailers.

(1) The influence of integration in reducing the cost of the large-scale retailer can be set forth by means of a simple illustration. In the grocery field the typical wholesaler contacts the independent retailer through a number of salesmen. Because the retailer (a) splits his business among a number of wholesalers, (b) orders frequently, and (c) has small weekly sales, the salesmen of each wholesaler have to make frequent calls on each retailer and be contented with small orders. Not only does this lead to a high selling cost, it also raises the cost of billing, credit extension and collection, and delivery. Because of frequent "fill in" orders, the wholesaler finds it difficult to maintain a regular and economically laid out delivery schedule.

* A.B., 1931, Colgate University; Ph.D., 1934, Harvard University. Professor of Economics, Colgate University. Author, Marketing (1938). Member Editorial Board, Journal of Marketing. Contributor to Harvard Business Review, Journal of Business of the University of Chicago, American Economic Review, and other periodicals.

[1] Any division of retailers into large and small is arbitrary. For purposes of this article chain stores, department stores, and mail-order companies will be considered as the main forms of large-scale retailing. In 1935 these retailers did 32.9% of all retail business. If independent supermarkets are considered as large-scale retailers, the foregoing ratios would be slightly increased; but as Census data are not yet available for such operators an all-over ratio cannot be given.

[2] One basic difference: more of the economies of large-scale manufacturing arise from the use of machinery.

In contrast, the units of a grocery chain concentrate practically all their purchases from a single chain-operated warehouse. No salesmen are necessary; headquarters provides the store manager with an order blank for his weekly order and requires that it shall be at the warehouse by a certain time. Delivery routes can be laid out to achieve the greatest economy while the size of the individual order reduces clerical and assemblying cost per dollar of goods delivered. Although it is contrary to popular opinion, Professor McNair is perfectly correct in stating that "integration of functions rather than large buying power is the principal source of chain store economies."[3]

(2) In the small store, specialization cannot be carried very far. Frequently the proprietor serves as buyer, salesman, bookkeeper, credit manager, advertising manager, and janitor. If he devotes adequate time to buying, some other function is neglected. But the large-scale retailer is able to place each activity in the hands of a specialist. In the department store, for example, a fourfold classification of acitivities is usual, with an executive in charge of each major activity. A store manager keeps the store's physical plant in condition, provides an adequate delivery system, secures personnel, and so on. The controller oversees the store's finances, accounting, and extension of credit. There is a publicity manager to handle all promotional efforts. Finally, the general merchandise manager is in charge of actual buying and selling activities. Of course, in the department store of any size, each of the foregoing specialists is assisted by a number of others. To illustrate, the store manager is assisted by a personnel director, a traffic manager, a head receiving clerk, and so on.

(3) While the possession of progressive management[4] may not be an inherent advantage of large-scale retailers, certainly in practice such management is far more characteristic of the large than of the small retailer. In part, this situation is a result of the fact that large retailers are merely the best of the small retailers grown up. The progressive management of large retailers is reflected in many factors. In many department stores it has led to the setting up of expense and merchandise budgets as guides for future operation. It is evidenced by a high rate of merchandise turnover in chain stores of various kinds. In the mail-order firms it is reflected in the adaptation of mail-order selling to modern conditions—through mail-order offices, overnight delivery systems, and more accurate word and picture descriptions of merchandise.

(4) Closely associated with progressive management is the large retailer's ability to engage in research. In fact, the research department of many retail organizations is looked upon as an arm of management. The store's customers may be studied in order that services and goods offered may be more in keeping with what they

[3] McNair, *Marketing Functions and Costs and the Robinson-Patman Act* (1937) 4 LAW & CONTEMP. PROB. 343. If a specific illustration is desired, consider the fact that the A. & P. can market a $3.00 box of oranges from a California shipping point to a metropolitan New York store for 12 cents (exclusive of freight) as against 46 cents for non-integrated marketers. Grocery Executive's edition of (June 1940) CHAIN STORE AGE 52.

[4] On this topic, *cf.* Taylor, *Progressive Retail Management* (May 1940) 209 ANNALS 46.

want. Aid may be given the real estate department in selecting suitable locations. Competitors' prices may be analyzed so that management will know its competitive position. For the small retailer the expense of a research department precludes its development, while the proprietor's absorption with other activities prevents him from doing very much himself along these lines.

(5) Buying merchandise in quantities is not a major advantage of all large-scale retailers. Many departments even in large department stores have sales volumes no larger than those achieved by independent limited-line stores. On the other hand, the chain store and the mail-order house can and do buy merchandise in quantities. Partly because such buying enables a manufacturer to effect economies and partly because it puts the retailer in a position to demand that he share in the savings, important quantity discounts are obtained. In addition, quantity buying is practiced as regards store equipment and fixtures, thus enabling the chain-store company to equip a number of units at a lower cost per unit than is possible for the independent.

Closely connected with quantity buying of merchandise and equipment is the large-scale retailer's ability to "buy" money for less. Of course, this ability to borrow money at a lower interest rate is only partly a result of the amounts he borrows; even more responsible is the fact that bankers and investors look upon the large-scale retailer as a better risk than the small retailer.

Ability to Undersell: Low Profit Margin

There is evidence, in certain fields at least, that large-scale retailers operate on a smaller net profit margin than their small-scale competitors. By way of illustration, Professor Vaile presents figures indicating a profit margin of 1.06 percent of sales for grocery chains, as against 1.96 percent for independent wholesalers and retailers combined, and 4.4 percent for voluntary chains.[5]

It should not be thought that the acceptance of a low profit margin decreases the total profits of large-scale retailers. Quite the contrary! What large-scale retailers are trying to do is to maximize their profits by taking a low net profit margin on a large volume of sales, rather than a large margin on smaller sales. This policy enables the large retailer to quote lower prices to the consumer.

Ability to Undersell: Limitation of Services

Some large-scale retailers, especially chain stores, have increased their ability to undersell some small-scale competitors by limiting the services performed. The majority of the chain stores sell on a cash and carry basis while, in some fields, they are placing their stores on a self-service basis. In the department stores operated by Sears, Roebuck and Company and Montgomery Ward the returned-goods privilege is restricted as compared with many small specialty shops.

Limitation of service on the part of the chain is not, of course, an inherent advantage; it can be done by any retailer as, for example, the independent supermarket.

[5] Statement by Roland S. Vaile, *Hearings before the Subcommittee of the Committee on Ways and Means on H. R. 1*, 76th Cong., 1st Sess. (1940) 14. Mimeographed.

But the chain, because of more progressive management, has been able to take the initiative in devising ways of limiting costly services, and still attract customers. In contrast, the large department stores have gradually increased the services which they offer to the consumer.

Prices of Large and Small Retailers

Unfortunately the evidence on prices asked by large and small retailers is limited to chain and independent stores, and especially to those in the grocery and drug fields. But that available does indicate that the economies of the chain store, its lower net profit margin, and its limitation on services have given it a substantial price advantage. A few years ago a Federal Trade Commission investigation put independent grocery store prices 8.5 percent in excess of chain store prices, and independent drug store prices 20.67 percent in excess of prices on comparable merchandise in chain stores.[6] At the end of 1939, John A. Hartford, president of the A & P, stated that prices in service grocery chains were 8 percent below prices in independent stores, while chain supermarket prices were an additional 8 percent lower.[7] A study conducted in 1935 in Florida found the chains underselling independents in the dry-goods and furnishings field from 3.1 to 17.8 percent, depending on the size of the chain, while on a small number of automobile accessory items the chain advantage was from 10.6 to 24.2 percent.[8] In view of these lower prices, it is not difficult to understand why, in a society such as ours where the average family has less than $1300 a year to spend on consumption items, consumers have sought out the large-scale retailers.

It is impossible at present to indicate exactly how much of the chain's price advantage is a result of each of the three factors making it possible. However, we may indicate that, contrary to popular opinion, the chain's low prices are not mainly a result of a lower cost of merchandise. Analysis of the Federal Trade Commission's figures reveals that but 16.4 percent of the grocery independents' high prices were a result of a greater cost of merchandise, while the comparable figure in the drug field was 8.8 percent. As the chain's advantage in a lower net profit margin cannot be great, it is evident that the main cause of its lower prices lies in its ability to operate for less than does the independent.

Improved Retailing Practices from the Consumer's Point of View

Integration, specialization, progressive management, and research have enabled large-scale retailers to do more than merely undersell competitors, important as such underselling may be. It should be emphasized that these factors have been equally important in enabling such retailers to improve on certain retailing practices, with the result that consumers are better served. This better service is evident in depart-

[6] Phillips, *The Federal Trade Commission's Chain Store Investigation: A Note* (1938) 2 J. MARKETING 191. As a result, at least in part, of fair trade laws, the drug chains' present-day advantage is less than that indicated by this study.

[7] Food Field Reporter, Jan. 8, 1940.

[8] BECKMAN AND NOLEN, THE CHAIN STORE PROBLEM (1938) 132.

ment stores where many "free" services have been added, but it is also important in chain store operation. For example, compare and contrast the average chain and independent grocery store. From external appearances the chain unit is more attractive, both in store front and in window display. Inside, its fixtures are more modern, its displays more attractive, and it gives the impression of greater cleanliness. Because of its standardized ordering routine, goods are less frequently out of stock.

Increasingly, large-scale retailers are adopting other practices as a means of attracting customers. Some of them are establishing merchandise testing bureaus so that they can offer merchandise which is better fitted to the needs of their customers. They are grade-labeling some of their merchandise. Locations are being selected with greater skill so as to be more conveniently placed for larger numbers of customers. Employee training programs seek to raise the caliber of the employee of the large organization. Both mail-order houses and department stores offer customers still another service which cannot be offered by the small retailer—a large variety of merchandise which can be purchased from a single source. For example, Montgomery Ward carries about 150,000 items in its general catalogue, some of which are not stocked by a single small retailer in many small towns.

Perhaps it should also be mentioned that large retailers sometimes take the lead, not only in reducing prices on an article, but also in having the article redesigned for greater consumer value. By way of illustration, consider what has happened in the production and marketing of the electric refrigerator.[9] Realizing that many customers were dissatisfied with the small boxes which manufacturers were producing to sell at moderate prices, in 1934 a leading mail-order house brought out a private brand box with six cubic feet of space and sold it for what three and a half and four cubic feet boxes were bringing through other retailers. The public responded to such a degree that this mail-order company became one of the country's three largest distributors of electric refrigerators. Old-line manufacturers were forced to follow its lead. While small-scale retailers might have sensed the demand for the larger, moderate-priced box and while eventually the manufacturers themselves would have developed such a box, only a large-scale retailer could take the initiative in speeding up this change in merchandising policy on the part of the manufacturers.

Large Profits

Even with advantages to offer the consumer, large-scale retailing would not have developed if profits had proven insufficient to attract capital and management to the field. While space is not available for the presentation of detailed statistical evidence, a study of the annual reports of large retailers will convince one that profits have been attractive. In spite of intense competition which the growth of the self-service store has brought to the food field, thirteen grocery chains in 1939 reported net

[9] NOURSE AND DRURY, INDUSTRIAL PRICE POLICIES AND ECONOMIC PROGRESS (1938) 108-109.

profit before interest of 11.65 percent on invested capital. During the same year ten variety chains had net profits of 13.4 percent and six mail-order companies of 16.66 percent.[10] By no means was 1939 the most profitable year for large-scale retailing.

AGITATION AGAINST LARGE-SCALE RETAILING

It is instructive to note that, in spite of the advantages which they have to offer, each type of large-scale retailer has faced organized opposition.[11] While the department store and the mail-order house survived the attacks aimed at them, the movement against the chain store gives promise of more telling effects. As a matter of fact, the small-scale retailer has much more to fear from the chain store than from any other type of large retailer. While the mail-order house has certain advantages, it is doubtful if conditions are such that it will develop greatly in the future.[12] The large department store faces certain difficulties in trying to draw customers from a wide area to a single store, and these difficulties increase as cities spread out. But the situation is different with a chain-store organization. Instead of trying to draw people to a single store, it makes use of the size stores best fitted for profitable operation and places them near to the customers.

In view of the greater long-run significance of the chain store threat, as well as the fact that agitation against the chain is playing such an important part in retailing today, the following paragraphs will be limited to an examination of the anti-chain-store position. With some changes, a similar case has been made out for opposing other large-scale retailers. Basically, the case for governmental interference with the chain store rests upon four propositions, each of which will be stated and subjected to a brief analysis.

Chain Stores Use Unfair Competitive Tactics

The particular practices of the chain stores which are now usually considered as unfair center around the chain's pricing of merchandise.[13] It is claimed that chain stores use loss leaders, that is, merchandise priced unreasonably low, as a means of attracting customers. To this complaint, two facts are pertinent. First, unless customers are attracted by a loss-leader policy into a store which has a relatively high average price, this policy is not harmful to the customer. As we have seen, chain stores have relatively low prices. Second, independent retailers can and do engage in the use of loss leaders. Professor Vaile, basing his opinion on studies of the retail

[10] Securities and Exchange Commission data: CENSUS OF AMERICAN LISTED CORPORATIONS (1939) Report 13, Supp. 19, at 14; Report 14, Supp. 11, at 9; Report 17, Supp. 16, at 9.

[11] The history of this opposition is given in Gould, *Legislative Intervention in the Conflict Between Orthodox and Direct-Selling Distribution Channels;* Feldman, *Legislative Opposition to Chain Stores and Its Minimization,* both *supra* this issue.

[12] For discussion, see PHILLIPS, MARKETING (1938) 373-378.

[13] A few years ago the chains were said to give light weights and to shortchange customers. However, studies of these practices have demonstrated the invalidity of such charges. See FED. TRADE COMMISSION, CHAIN STORES: SHORT-WEIGHTING AND OVER-WEIGHTING IN CHAIN AND INDEPENDENT GROCERY STORES (1933); Taylor, *A Study of Weights in Chain and Independent Grocery Stores in Durham, North Carolina* (1931) 9 HARV. BUS. REV. 443.

trade in Minnesota, feels "that independent stores use loss leaders as frequently as do chain stores."[14]

It should be pointed out, however, that chain stores are in a particularly good position for making use of loss leaders. By rotating leaders among stores in various sections, the chain always has some stores turning in "normal" profits while others are establishing a reputation for low prices.[15] In contrast, deep-cut prices on the part of the independent may substantially reduce his net profit in the only store from which it is obtained.

Chain Stores Are Unfair to Their Employees

Chain stores are deemed unfair to their employees in that they require long hours of work, pay low wages, encourage dishonest practices, and offer little chance of advancement. On none of these points is the evidence conclusive. As regards working hours, it is the writer's opinion that chain store hours are certainly no longer—and they may be somewhat shorter—than those required in competing independent stores. Studies of chain and independent wages are in conflict; a Federal Trade Commission investigation gives the advantage to the independent,[16] while Census data are favorable to the chain store.[17] As a matter of fact, because the greater specialization in the chain store allows it to make use of some employees with relatively low abilities, it is doubtful if statistics of chain and independent wages are comparable enough to have any validity. It seems logical that either the chain or the independent would face difficulties in holding employees receiving less than the comparable employees of other stores.

The charge that chain stores encourage their employees to be dishonest probably has little foundation. It arose out of the policy of charging all merchandise to the stores at the retail price. As some shrinkage is inevitable, because of theft and spoilage, some persons maintained that the manager would have to cheat the customer to make up the shrinkage, or show an inventory shortage which would jeopardize his position. Such is not the case. Because shrinkage is inevitable, allowance is made for it and only an abnormal shrinkage causes the personnel department to look with suspicion upon a manager. Actually, it is somewhat difficult to imagine a person being more dishonest merely to hold his job than he would be as an independent proprietor when dishonesty might be reflected in an immediate increase in his profits.

Unfortunately, many chain store employees will never advance very far; and even more unfortunate, because more persons are involved, is the fact that this same statement is true of employees in independent stores. The plain fact is that retailing employs a large number of persons whose abilities do not fit them for any great promotion. But for the able employee, attractive advancement opportunities are available in chain organizations. Managers of small stores may advance to managerships

[14] *Hearings*, *supra* note 5, at 16.

[15] For a discussion of pricing by food chains, see Phillips, *Price Policies of Food Chains* (1941) 19 HARV. BUS. REV. 377.

[16] FED. TRADE COMMISSION, CHAIN-STORES: CHAIN STORE WAGES (1933) 17-21.

[17] *Retail Distribution*, in 1 CENSUS OF BUSINESSS 1935 (U. S. Dep't Com. 1937) 2-13.

in large stores, or become superintendents, district managers, buyers at headquarters, and so on. Even managerships in the larger chain units frequently give an annual return in excess of $10,000.

Chain Stores Drive Independent Retailers Out of Business

This claim has several aspects. First, complaint is registered against the methods used by the chain; that is, that chains force independents out by means of loss leaders, underweighting, and low wages. Second, it is suggested that small retailers are socially more desirable than large retailers, so that all large-scale retailers are to be opposed. Third, and finally, fear has been expressed that all small-scale retailers will be driven out of business, thus leaving large retailers in a monopolistic position. The first of these three aspects has been examined in preceding sections and, in the main, found wanting, while the third will be treated in the following section. It is with the second aspect that we are now interested.

Small retailers are deemed preferable to large-scale retailers because it is felt that the chain store represents absentee ownership, taking little interest in the progress of the communities in which it operates. Managers are transferred frequently so that they do not have time to become assets to the locality. By drawing off profits to headquarters, the chain drains money out of the community so that it becomes difficult to keep the town prosperous. By various devices, especially a rapid stock turnover, chains are said to avoid their share of taxes.

We have enough information to give definite answers on some of these issues. Studies indicate that chain stores actually pay heavier taxes than do independents.[18] While money profits are transferred out of town, it must be remembered that in an exchange economy such as ours the main purpose of money is to serve as a medium of exchange. As long as the community gains by the exchange there is no reason for complaint; that it does gain in some degree is indicated by the fact that the chain's price advantage is greater than its net profit margin.

The answer to the charge that the chain's absentee ownership is socially undesirable must be somewhat indefinite as we have no exact test of just what is socially desirable. Yet it is important to note that many chains are taking steps to build themselves into community life. Managers are being encouraged to join local clubs and to become active in them. A certain percentage of the sales of each store is put at the disposal of the manager to be contributed to worthy local activities. Of course, many chains are still far from being as good "citizens" as is desirable, but we should not overlook the fact that by no means are all independent merchants the community-minded men they are sometimes pictured.

Even though the statement may sound harsh, we need to understand that many small independent retailers probably deserve to fail. In 1935, 44.5 percent of all independent stores had sales of less than $5,000 and 64 percent of less than $10,000.[19]

[18] Fish, *Comparative Chain and Independent Store Taxation in Nine Western States* (1939) 24 BULL. NAT. TAX ASS'N 275.

[19] *Retail Distribution, supra* note 17, at 1-31.

In stores so small the owner can barely eke out a living. While some of them are in the hands of efficient operators who will gradually expand them into larger units or are in fields where very small retailers are desirable, the majority of them are ineffectively operated and their relatively high prices are a burden to society. As one travels around the country and observes small stores, his wonder is not that so many of them fail, but that so many of them are able to remain in business. Perhaps Professor Taylor does not overstate the matter when he writes:[20]

> The only conclusion that one can draw from the statistical evidence now available is that the average independent retailer is incompetent and inefficient and that his continuance in a business which is unprofitable to himself constitutes a serious economic problem.

Perhaps it is time we begin to think about saving the consumer from the cost of supporting a host of small retailers!

Popular opinion to the contrary, the development of the chain store has not increased the rate at which small independents fail. Several studies substantiate this conclusion. To cite but one of them:[21]

> The life of the independent retailer was as precarious before the day of the chain store as at present. And some types of enterprise where competition of the chain store is not a factor . . . have a higher mortality than those . . . where chain-store competition is most acute. Consequently elimination of the chain store is not the indicated remedy.
>
> The simple fact is that the high mortality is the price of a laissez-faire system; and any attempt to assist the small independents by suppressing their larger competitors is apt to decrease the average life of retail concerns as a whole without increasing the lives of the independents it is intended to protect.

While it is true that chain stores are now doing a substantial volume of business which might otherwise be transacted by independent retailers, it seems likely that independents would be failing as rapidly as today if there were no chain stores. So many independent stores are so poorly managed as to be unable to compete even with the better-operated independents. It is doubtful if the displacement of many of these poorly-managed independent stores by chain stores is opposed to social welfare.

Chain Stores Are Monopolistic

Isn't there a likelihood that the replacement of independents by chain stores may go so far that no independents are left? Under such circumstances would not the chains be in a position to take monopoly profits by raising prices? The answers to both of these questions, as the following discussion will indicate, are in the negative.

Those who worry about the chains driving all independents out of business fail to consider the advantages which accompany independent operation. Personal contact of proprietor with his customers gives him an opportunity to build his stock and services to meet the needs of the customers involved. Personal contact with

[20] Taylor, *supra* note 4, at 47.

[21] Hutchinson, Hutchinson and Newcomber, *A Study in Business Mortality* (1938) 28 AM. ECON. REV. 497, 514.

employees enables him to build a loyal organization. All decisions are made within the store so that they can be made quickly. While the independent may be undersold, the importance of non-price competitive elements suggests that by no means will all customers desert him. In spite of chain competition, the independent retailer still dominates practically all retail fields.[22] Moreover, independents are still finding it possible to enter retailing and compete with the chains.[23] In fact many of them are competing so successfully that they are developing small chains of their own.[24] As long as the chance of successful entry into retailing remains open, chain stores can never drive all independents out of the field.

We can go even further than is suggested by the preceding paragraph. There are factors other than the advantages of the independent retailer which indicate that, even in the absence of governmental regulation, the chain store will find it difficult to increase its percentage of total retail business. Many independent retailers have adopted better retailing practices and have joined together to effect joint buying, advertising, and other merchandising activities. Some of them are meeting chain store competition through the establishment of supermarkets. Consumers' co-operatives are growing and may prove to be a competitive element retarding chain store growth. Many customers do not like the standardization which characterizes the chain store. As chains grow in size, personnel and managerial difficulties become greater. There is evidence that even the chain's price advantage over the independent does not increase in proportion to the size of the chain.[25] The profit margin in chain store operation was falling long before 1929.[26] This decline will be a factor in slowing up the expansion of existing chains and in making the field less attractive to outside capital. Finally, it must not be overlooked that interchain competition is of increasing importance, and would exist even in the absence of independent retailers.[27]

SOME CONCLUSIONS

The preceding paragraphs have suggested that large-scale retailing has certain advantages to offer the consumer which, in practice, cannot be offered by small independents. In view of the low incomes of the majority of consumers, it seems doubtful if the alleged evils of the chain store are sufficient to justify restrictions of the types which have been imposed upon them during the last decade. It has also

[22] In 1935, in but one (variety) of 25 retail fields did the independent do less than 10 percent of all business. In three fields his ratio was 40-49.9%, in one 50-59.9%, in three 60-69.9%, in nine 70-79.9%, and in eight in excess of 80%. *Retail Distribution, supra* note 17, at 1-24.

[23] Between 1929 and 1935 the number of independents increased by nearly 100,000 while the number of chain units fell by 20,000. See Census data summarized in PHILLIPS, MARKETING (1938) 363, 437.

[24] For example, see Phillips, *Why Laws to Aid Small Stores are Unnecessary* (Dec. 2, 1937) PRINTERS' INK 13, 82.

[25] Phillips, *An Economic Analysis of the Supreme Court's Decisions on Chain Store Taxation* (1938) 11 J. BUS. UNIV. CHI. 51, 62-63.

[26] The Federal Trade Commission reports the following profit-to-sales ratios for chains in a number of fields: 1919, 7%; 1922, 6.4%; 1925, 5.6%; 1927, 4.8%; 1928, 4.6%; 1929, 4.1%; and 1930, 2.9%. CHAIN-STORES: SALES, COSTS, AND PROFITS OF CHAIN STORES (1933) 28, 29, 31.

[27] With the above analysis compare the position taken by Wolff, *Monopolistic Competition in Distribution, supra* this issue.

been suggested that there are a number of factors which will tend to limit chain store growth, even in the absence of legislation. It might be added that, if future experience should demonstrate that the chains are paying wages or exacting hours of labor that are felt to be socially undesirable, legislation aimed directly at these matters is more acceptable than chain store taxation. Such specific legislation would correct the situation without, as is inevitable with chain store taxes, penalizing innocent chain store operators and raising prices to the consumer.

Unless resort is had to legislation, retailers best meeting consumer demand will continue to replace those less able to satisfy it. This is the basic law which has been exemplified in the growth of the chain store. If we really want to keep retailing in the hands of independent merchants, perhaps we should begin to aid the independent to become a better merchant. Such an approach, if successful, would do more than keep the independent—it would also make for greater efficiency in marketing. Of course, the chain store tax approach, carried far enough, will keep the independent, but it will do nothing to increase efficiency in retailing. In fact, chain store taxes tend to make less efficient a field which already gives evidence of harboring a vast amount of inefficiency.[28]

[28] STEWART AND DEWHURST, DOES DISTRIBUTION COST TOO MUCH? (1939) 320-325.

MUNICIPAL LEGISLATIVE BARRIERS TO A FREE MARKET

JOHN A. MCINTIRE*
CHARLES S. RHYNE†

Municipal ordinances having the possible effect of restricting a free market are more voluminous than any other single type of barrier legislation. The more than 7,000 municipalities in the United States, not to mention other local subdivisions of states possessing a measure of legislative power, have all adopted ordinances which intentionally or unintentionally operate in one way or another as barriers to the unfettered economic operation of the market within their areas. This vast volume of local legislation certainly calls for consideration aside from its counterparts in state and federal laws. The term barrier in this context is descriptive of a broad result only, and is not used in the sense of evaluating the legislation as desirable or undesirable. Throughout this discussion there will be no attempt made to determine as a matter of political philosophy or economic policy what types of local ordinances may be regarded as justified or unjustified. Regardless, however, of its merits, there are certain fundamental principles relating to the power of municipal corporations to which legislation of this type must conform if it is to be sustained by the courts. Many of these principles constitute Achilles' heels by which ordinances that are considered undesirable can be legally attacked.

The history of local ordinances relating to economic affairs traces from the earliest of municipal legislative activities.[1] Even in the Middle Ages some of the principal activities of municipal authorities dealt with efforts to control matters of trade and industry, particularly with respect to importing and exporting, matters of

* A.B., 1928, Wittenberg College; LL.B., 1931, University of Cincinnati; Research Fellow, Harvard Law School, 1935-1936. Member, Ohio, United States Court of Appeals of the District of Columbia, and United States Supreme Court Bars. Associate Professor of Law, George Washington University; Faculty Editor-in-Chief, GEORGE WASHINGTON LAW REVIEW. Formerly, Executive Director, National Institute of Municipal Law Officers, and Editor, MUNICIPAL LAW JOURNAL, 1937-1941. Consultant to the National Institute of Municipal Law Officers; International Association of City Managers. Co-author (with C. W. Tooke), CASES ON MUNICIPAL CORPORATIONS (1941); articles on municipal law and government corporations in various periodicals.

† Duke University, 1928-1929, 1932-1935; LL.B., 1937, George Washington University. Member, District of Columbia and United States Supreme Court Bars. Executive Director, National Institute of Municipal Law Officers; Editor, MUNICIPAL LAW JOURNAL. Formerly, Attorney, National Institute of Municipal Law Officers, and Associate Editor, MUNICIPAL LAW JOURNAL, 1937-1941. Author, CIVIL AERONAUTICS ACT ANNOTATED (1939); articles on aviation law in various periodicals.

[1] The Case of the City of London, [1610] 8 Co. Rep. 121 b, 77 Eng. Rep. 658. See also for discussion of prescriptive power to exact license fees for weighing cheese in the City of London, City of London v. Thomas Perkins, [1734] 3 Brown P. C. 602.

competition, control of price, quality, *etc.* In many by-laws the admitted and avowed purpose was to control competition in favor of the local inhabitants.[2] The establishment and regulation of public markets, a power of cities having its roots in the earliest organized societies, was one of the early functions of the English borough.

While the sphere of economic regulation is not at all a new topic for the consideration of municipal legislative bodies, the scope and volume of local laws of this character is constantly increasing. Investigation of many building codes reveals that their specifications operate as barriers to the use of particular types of materials or particular merchandising methods. For instance, the code standard for the thickness of plaster lathe as an element in fireproof construction may be so designed as in effect to exclude the use of metal lathe. Provisions of the Chicago building codes restrict the use of such lumber substitutes as hardboard and insulation board. These limitations are accomplished by specifying the products which are satisfactory under the fire laws instead of admitting any product which meets a specific fire test. Because of different construction principles employed in the prefabrication of dwellings, building codes will often, in effect if not by design, impede the use of this new type of construction.[3] The specific content or administrative operation of many of the existing municipal electrical codes, plumbing codes, *etc.*, also furnish examples of provisions accidentally or purposely preferring one kind of equipment or method of distribution over another.[4] It has been pointed out that the plumbing code of a Pennsylvania city requires all registered plumbers to pay a fee of one dollar a fixture for every installation. Every non-resident plumber, wishing to work in the city, must register with the Board of Health and pay a registration fee of $25-$50 for each job to be performed in the city. There is some indication of a trend at the present time toward promulgation under local police power of general codes regulating particularly local service occupations.[5]

In St. Louis, Missouri, and Dayton, Ohio, sticker ordinances have operated as effective deterrents to the sale of plumbing fixtures by mail-order houses. These ordinances provide in general that in order to secure inspection approval, all plumbing fixtures installed must have affixed a sticker secured from the city. The firm selling the fixtures must also make a report indicating the place of installation of every piece of equipment which it sells.[6] This requirement is little more than a

[2] 1 MCQUILLIN, MUNICIPAL CORPORATIONS (2d ed. 1928) §65; 1 *id.* (rev. ed. 1940) §941.

[3] See State *ex rel.* v. Yoter, 65 Ohio App. 492, 30 N. E. (2d) 558 (1939); see also Matill v. City of Chattanooga, 132 S. W. (2d) 201 (Tenn. 1940).

[4] In the building trades investigation of the United States Department of Justice, numerous instances of "barriers" in favor of local dealers and labor have been uncovered. Dean, *Some Problems Arising in the Enforcement of the Anti-Trust Laws*, in MUNICIPALITIES AND THE LAW IN ACTION (Nat. Inst. Mun. Law Officers, 1939) 273-280.

[5] *Report of Committee on Social and Economic Regulation of Industry*, in MUNICIPALITIES AND THE LAW IN ACTION (Nat. Inst. of Mun. Law Officers, 1940).

[6] Address of Corwin Edwards, *Restraints in Building Codes*, Central Housing Discussion Papers : G : 1940 Series. See Dayton, Ohio ordinances No. 14939 and No. 15052, litigated in Dayton v. Bohachek, 26 Ohio L. Abs. 417 (Ohio App. 1938); Direct Plumbing Supply Co. v. Dayton, Ohio Common Pleas, Montgomery County, No. 88186, 1940 (unreported).

time-consuming irritation for the local plumbing trade, but represents a major difficulty to the doing of business by a mail-order house. The Green River type ordinance, prohibiting house-to-house canvassing without the consent of the individual householder, is perhaps the most drastic local regulation directed at a particular method of doing business.[7] Municipal chain store taxes are also well-known examples of this situation. Recently, in New Jersey as well as elsewhere, local merchants demanded municipal legislative protection against the supermarkets which are a common phenomenon in every city.[8]

Product favoritism in Seattle took the form of legislative aid to liquid as against solid fuel. In Chicago, milk control legislation has even been directed against the use of paper containers in favor of the use of the standard glass bottle.[9] Many ordinances, ostensibly adopted for the purpose of protecting the local public health by requiring inspection of the milk supply, have had an extraterritorial operation which discriminates against non-residents.[10] Furthermore, taxes or regulations affecting not only hawkers and peddlers, and more recently solicitors and canvassers, but also such businesses as bakeries, barber shops, beauty parlors, food stores, amusement facilities, cleaners and dyers, dairies and milk distributors, clothing and department stores, and other occupations and industries, may actually be designed to operate to the advantage of local concerns as against non-resident competitors.

Ordinances of market-barrier significance may thus operate either geographically, in an attempt to grant a preference to the local market, or non-geographically, in an attempt to discriminate in favor of one commodity, method of doing business, or class of dealers. Inasmuch as a systematic survey throughout the whole United States of all local codes and ordinances operating as municipal market barriers is impractical, the study here presented makes no pretense of such comprehensive treatment.[11] Enough has been indicated, however, to illustrate the scope of local ordinances that may have the effect of impeding the ordinary economic operation of local markets. Further instances will appear in the ensuing discussion, and can also be found in other articles in this symposium.

Although no position is here taken with respect to the justification or desirability of any particular ordinances operating as market barriers, nevertheless it will perhaps be useful to suggest both sides of the picture from the local point of view. On

[7] Town of Green River v. Bunger, 50 Wyo. 52, 58 P. (2d) 456 (1936); Green River v. Fuller Brush Co., 65 F. (2d) 112 (C. C. A. 10th, 1933). Local legislation in two New York cities has been directed against peddling in a particular business. People v. Kuc, 272 N. Y. 72, 4 N. E. (2d) 939 (1936) (newspaper); Dugan Bros v. City of New York, 7 N. Y. S. (2d) 162 (1938) (bakery products). Both ordinances were invalidated.

[8] See the ordinance of the City of Camden, New Jersey, set forth in Great A&P Tea Co. v. Board of Comm'rs of Camden, 4 A. (2d) 16 (N. J. 1939).

[9] Fieldcrest Dairies, Inc. v. City of Chicago, 35 F. Supp. 451 (N. D. Ill. 1940); Ex-Cell-O Corp. v. City of Chicago, 115 F. (2d) 627 (C. C. A. 7th, 1940).

[10] See, *e.g.*, City of Rockford v. Hey, 366 Ill. 526, 9 N. E. (2d) 317 (1937); (1938) 36 MICH. L. REV. 850.

[11] Sikes and Parrish, *Municipal Trade Barriers* (1940) 16 IND. L. J. 220 and Note (1940) *id.* 247, attempt a comprehensive analysis of Indiana ordinances.

the one hand, market-barrier legislation may be condemned as an evil tending toward creation of unfair discrimination with respect to areas or products and tending toward disruption of national economic unity. On the other hand, a good case can be made out for justifying some legislation of this type. Out-of-city or non-resident dealers entering the local market area receive the benefit of local protection of the market and enjoy the benefit of many local municipal services without in either case contributing any *quid pro quo* to the local treasury.[12] The resident dealers with whom they compete under the resulting advantageous conditions naturally demand some equalizing factor to offset the local burdens incumbent upon them.

In addition there are other circumstances in which a regulation designed to set up a protective barrier around a local market area may, from one point of view, be entirely justified. One example of this is the following actual problem which confronted a small Missouri town about three years ago. The local used-car market was being demoralized by certain dealers from the nearby large metropolitan areas who would ship large quantities of used cars into the town for sale at cut-throat prices. The business methods employed were also questionable; the out-of-the-city concern would send large quantities of cars on consignment to an unknown and irresponsible dealer who would rent temporary quarters and might abandon the business overnight, leaving little or no trace as to his whereabouts. The local used-car dealers suffering from the effects of this competition demanded municipal legislation in their interest. Clearly, no legislation in the form of an anti-dumping law could properly or effectively be adopted which would have the open and avowed purpose of prohibiting this practice. Nor would the imposition of a larger fee for a non-resident dealer be a valid solution. The device suggested was the use of the local power to protect the public from fraud in business transactions. As an incident of the police power the local city council had authority to prescribe reasonable regulations designed to insure that the purchaser of a used car was not getting a stolen vehicle. In order to defray the cost of investigation of used cars offered for sale, a nominal license fee could be charged. It is also arguable that it would have been reasonable to have required the dealers to register with the local authorities any used car brought in for sale from outside the local area and to withhold any sale of such cars for a short period of time in order to permit a police check on the documents of title. The small profit differential and the temporary character of the business of the consignment-sale dealer were such that the nuisance of these rather minor regulations was sufficient to discourage the offending business practice and to reach the desired result.[13]

[12] The New York City sales tax cases are a recognition of the liability of non-residents to pay a share of the cost of local government in the face of the long claimed "immunity" of non-residents from local tax burdens under the commerce clause. See Chanler, *The Commerce Clause and Municipal Taxation*, in MUNICIPALITIES AND THE LAW IN ACTION (Nat. Inst. Mun. Law Officers, 1940).

[13] National Institute of Municipal Law Officers, Report No. 30, Opinion Bull. No. 3 (1937). *Cf.* State v. Ernst, 297 N. W. 24 (Minn. 1941), holding invalid as discriminatory against non-residents a statute which required a bond and $5 fee for all used cars brought into the state; Motor Trading Co. v. Ingels, 110 P. (2d) 132 (Cal. App. 1941), holding similarly with respect to an analogous statute.

Legal justification for local taxation is the power derived from the state by an express constitutional or statutory authority to raise revenue. The fundamental basis for local exercise of regulatory authority over economic matters, however, is the police power to protect the public from fraud and dishonest practices. Local, like state, power to regulate business has been for some time restricted to a direct relation to the protection of health, morals, or safety, or to general regulation of business affected with the public interest. Since the case of *Nebbia v. People of New York*,[14] the permissible scope of state and local economic regulation of industry has been much expanded.[15] Thus local police power has been recognized as extending to regulation of unfair competition, and even to combinations in restraint of trade.[16] While municipal legislation may be considered together with state legislation of a comparable nature for application of the common tests of constitutionality, local laws are subjected to additional judicial scrutiny in view of the limited powers of cities, territorially and otherwise, and of the authority of the courts to pass upon the reasonableness of ordinances as exertions of delegated powers.[17] Because of the definite limits to municipal authority, in passing upon the validity of local ordinances courts determine the scope of the charter power possessed by the local authority, whether that power has been properly pursued, whether the matter regulated is one of local as distinguished from state concern, and whether there is inconsistency with state law. And while the motives of neither local nor state legislative bodies may be inquired into in determining the legality of legislation, nevertheless the broad scope of local ordinances enacted pursuant to implied powers affords room for a rather broad consideration of the general economic effect and justification of restrictive legislation.[18]

The following discussion of legal problems receiving the attention of the courts with respect to barrier legislation is believed to be representative of the whole situation. Acquaintance with these problems, it should be frankly stated, is based on the writers' personal day-to-day contact with and observation of such ordinances, and the questions presented to city attorneys for litigation or for the advice of city administrators and councilmen faced with the reasonable or unreasonable legislative demands of interested groups. Although representative of but a small segment of the whole, a great many problems are presented to the courts each year requiring a consideration of the principles involved in the legality of such local ordinances as have a barrier effect.

Altogether these principles number five: first, the relation of the ordinance to the police or revenue powers; second, the reasonableness of the ordinance and the extent of judicial inquiry into economic factors in this connection; third, the effect of the ordinance on interstate commerce; fourth, the effect of the ordi-

[14] 291 U. S. 502 (1934).

[15] Kelly-Sullivan, Inc. v. Moss, 22 N. Y. S. (2d) 491 (1940), noted (1940) 9 GEO. WASH. L. REV. 242.

[16] See note 5, *supra*.

[17] DILLON, MUNICIPAL CORPORATIONS (5th ed. 1911) §600.

[18] Yick Wo v. Hopkins, 118 U. S. 356 (1886); LeFeber v. West Allis, 119 Wis. 608, 97 N. W. 203 (1903).

nance as to non-residents; fifth, the effect of the ordinance with respect to extra-territorial operation. In addition, the application of the privileges and immunities clauses of state and federal constitution may be involved.[19] Fundamentally, all local legislation of this type relates to some phase of either of two basic municipal powers, namely: police and revenue. The revenue measures adopted for the purpose of raising funds may have a more important incidental regulatory effect, but nevertheless, as revenue measures, they must be justified under the constitutional or the express legislative authority to tax. Police legislation is directly designed to regulate individual conduct and may relate to either express or implied power. Regulatory measures may involve license fees which sometimes resemble revenue exactions, but they must, as distinguished from taxes, bear a reasonable relation to the cost of the police power regulation involved.[20] If the collections from the regulatory license fees grossly exceed that cost, the court may declare that the actual intent is revenue-producing and the measure will accordingly be held invalid in the absence of the power to tax.

The problem thus raised as to the source of the municipal power exercised in a given instance is illustrated by two recently litigated cases. A Los Angeles ordinance attempting to tax department stores was held to be based on a classification too indefinite for the purpose of taxation,[21] while an ordinance imposing a $25 license tax by the City of Seattle on each dealer in solid fuel plus a $15 fee for each fuel truck used in excess of one was invalidated as a discrimination between solid fuel and liquid fuel dealers.[22] The Seattle solid fuel tax measure was claimed by the municipal authorities to be levied as a police regulatory measure and therefore not required to be based on the same kind of classification that would be required for a revenue measure. This distinction was held immaterial in that case, but it has been treated as significant in many instances.

While there are innumerable examples of local regulatory measures which operate as market barriers through non-geographic discriminations, the problem is one for the legislature, unless the measure can be established as arbitrary or capricious

[19] Since the case of Robbins v. Shelby Taxing District, 120 U. S. 489 (1886), the privileges and immunities clause has been of practically no importance in federal court decisions in this connection. This is not correspondingly true of state litigation, however. *Cf.* New York v. Roberts, 171 U. S. 658 (1898), and State v. Cohen, 133 Me. 293, 177 Atl. 403 (1935). Since the decision in the New York City sales tax case, however, McGoldrick v. Berwind-White Coal Co., 309 U. S. 33 (1940), it is probable that litigants will again seek to rely heavily on a privileges and immunities argument.

[20] The nature of a license fee not charged for revenue purposes is an assessment of the cost of regulation against the object regulated. It is therefore an incident of the police power and unless expressly authorized in the form of a revenue-producing fee it must bear a reasonable relation to the cost of regulation. A court, however, will not examine mathematically the exact allocation of cost on any accounting basis, but will give a presumption of validity to the assessment charged as a fee unless it can be shown that the charge has no relation to the cost at all. See *In re* opinion to the House of Representatives, 5 A. (2d) 455 (R. I. 1939); 1 COOLEY, TAXATION (4th ed. 1924) §27; *cf. Ex parte* Holt, 74 Okla. 226, 178 Pac. 260 (1918); Atkins v. Philips, 8 So. 429 (Fla. 1890).

[21] Barker Bros. v. City of Los Angeles, 10 Cal. (2d) 603, 76 P. (2d) 97 (1938); *cf.* City of Chicago v. Nechter, 183 Ill. 104, 55 N. E. 707 (1899).

[22] Pierson v. City of Seattle, 119 Wash. 217, 90 P. (2d) 1020 (1939); see also S. S. Kresge Co. v. Couzens, *infra* note 44.

or definitely directed against one group of persons for the private advantage of another and without any real relation to the public interest. The fact that the ordinance may in operation work to the advantage of one product or method of doing business and to the disadvantage of another, is of no legal consequence if the public interest in the exercise of the local police power presents a reasonable relation to the subject matter of the regulation. Here, as in any local law adopted pursuant to an implied power, the question of reasonableness is one of law.

The best known contemporary local tax ordinances having barrier effects are undoubtedly the local tax laws directed against chain stores. These ordinances have been adopted in a variety of forms. They have been based in some instances on a classification of business according to its gross revenue, whether received from business done within or without the city.[23] Some have been graduated according to the number of units in the whole chain operating within the city,[24] or in some situations the number of units operating in the system, wherever situated.[25] Others, with an eye to the "serve yourself" systems, have been based upon a classification of the method by which particular chain store operators conduct their business.[26] In any case, these ordinances have usually been designed, more or less frankly, to equalize the positions of the single-store dealer and the chain operator. They are practically all revenue measures as distinguished from police power license fee exactions. They, therefore, involve either a constitutional power to tax or an express legislative delegation of the power to raise revenue by taxation or occupational license fees.

In these cases three general problems, in addition to the obvious one of the existence of the power to tax for revenue purposes, have been considered. Since a tax directed against a chain store business must involve a classification in order to reach the desired subject, the relation of the classification adopted in the local ordinance, as compared to the differentiation made for tax purposes by state legislation, creates a problem. A further problem exists by virtue of the fact that any classification for the purpose of a revenue tax must be non-discriminatory and based on a reasonable difference in fact between the classes taxed and those not taxed, so that the tax law may have a uniform operation. Finally, although the power to tax is granted in unlimited form and with no restriction as to amount, nevertheless, the power to tax does not carry with it the power to prohibit a lawful business. Any tax legislation, therefore, must not in its operation be confiscatory.

As a general rule it has been held that a city has no power to adopt a basis of classification for tax purposes different from that which has been established by the state itself. If, on the other hand, the state has made no classification as to the subject matter to be taxed, then the local action will be upheld without reference to any state system. In some cases, the courts, in order to sustain the municipal law,

[23] City of Atlanta v. Georgia Milk Producers Confederation, 200 S. E. 712 (Ga. 1938).

[24] Kroger Grocery and Baking Co. v. City of St. Louis, 341 Mo. 62, 106 S. W. (2d) 435 (1937).

[25] Great A&P Tea Co. v. City of Columbus, 189 Ga. 458, 6 S. E. (2d) 320 (1939); City Council of Augusta v. Southern Grocery Stores, Inc., 189 Ga. 618, 7 S. E. (2d) 181 (1939).

[26] So of the Camden ordinance described in note 37, *infra*.

have gone rather far to establish a distinction between the state and local classifications of the subject matter of the tax. The ordinance of St. Louis, Missouri, providing for graduation of a license-fee tax according to the number of stores, is an example of an ordinance invalidated because of its relation to the classification established by state law. The state law had provided for local authority to tax and regulate the occupation of merchants and manufacturers and to graduate the amount in proportion to the sales made by the merchant or manufacturer during the year next preceding any fixed date. Considering the validity of the ordinance in the case of *Kroger Grocery and Baking Co. v. City of St. Louis*,[27] the Supreme Court of Missouri held that the state law with respect to the method of classification for the purpose of a license was mandatory and not directory, and the local method of classification inconsistent therewith.

Other similar examples may be cited. A power to tax in proportion to sales has been held not to authorize a tax based on the floor space used in the business.[28] So also has the power to tax single occupations been held not to authorize a local ordinance attempting their subdivision into various phases; thus the business of contractors generally, as provided by state law, cannot be divided by local ordinances into the trades of brick mason, plastering contractor, roofing contractor, electrical contractor, *etc.*[29]

On the other hand, in the case of *Fredericksburg v. Sanitary Grocery Co.*[30] the court held valid a local classification based on the number of stores in excess of one, as compared to the state law authorizing the tax but making no such classification. The court held that the city had not, by its local ordinance, attempted a subdivision of the class created by the state, but that it had created the entirely new classification of chain store merchants. In this case also, it is interesting to note, the court invoked, as against the charge of discrimination, the principle that the party assailing the classification must show that the business discriminated against is precisely the same as that included in the class which is alleged to be favored. Further examples of the validity of a local classification, in the absence of a controlling state classification, are *Bradley v. Richmond*,[31] *Williams v. Bolling Green*,[32] and *Safeway Stores v. Portland*.[33] In the *Safeway Stores* case, charter authority to grant licenses with the object of raising revenue or of regulation or both for any and all lawful acts, things, or purposes, and to fix by ordinance the amount to be paid therefor and the bases of revocation, was held sufficient to sustain an ordinance imposing an annual license fee of $50 on each store of a chain in excess of 20, whereas a single store was obliged to pay only $6.

It is a well-settled principle that the operation of a local tax law as a revenue measure must be uniform on all persons in the same position.[34] As a corollary to

[27] *Supra* note 24.
[28] Kansas City v. J. I. Case Threshing Machine Co., 337 Mo. 913, 87 S. W. (2d) 195 (1935).
[29] Norfolk v. Griffin Bros., 120 Va. 524, 91 S. E. 640 (1917).
[30] 190 S. E. 318, 110 A. L. R. 1195 (Va. 1937).
[31] 227 U. S. 477 (1913).
[32] 254 Ky. 11, 70 S. W. (2d) 967 (1934).
[33] 149 Ore. 581, 42 P. (2d) 162 (1935).
[34] MCQUILLIN, MUNICIPAL CORPORATIONS (2d. ed. 1928) §2540.

this principle, any classification for the purpose of taxation must bear a reasonable relation to the facts and not arbitrarily discriminate between individuals identically situated.[35] It has been contended in several of the chain store tax cases that singling out the chain stores for the purpose of taxation is an unconstitutional discrimination against them as an ordinary means of business, not essentially different from any other method of selling. It has been generally held, however, as against this contention, that the different method of doing business is a sufficient differentiating basis for the purpose of classification. Thus in the *Safeway* case this objection was overruled by pointing out that:[36]

> There is a real, recognized difference between a business carried on in one store and a business operated by means of a chain of stores. Whether it is wise or expedient based upon such difference to classify such chain stores in a class by themselves for the purpose of levying a license tax is, as we understand, a legislative question to be determined by the lawmakers.

A notable exception to this view is the opinion of the court in the case of *Great A&P Tea Co. v. Board of Commissioners of Camden, N. J.*[37] The Camden ordinance, it is known, was directed against the supermarket. It was there held that the imposition of a tax for revenue purposes upon self-service markets, as distinguished from markets in which goods were sold by clerks, was an arbitrary discrimination between persons engaged in the same business merely because one merchant chose a method of making sales which another did not use. The leading case sustaining chain store taxation by the state was distinguished in these words:[38]

> The classification in question has not the slightest resemblance to classification predicated upon a desire to adjust competition or economic inequalities between merchants sustained in *Great Atlantic and Pacific Tea Co. v. Grosjean.*

Similar to the chain store tax situation are other revenue taxes assessed on a basis intending to discriminate against non-residents in favor of local dealers. While some classification on this basis is permissible in order to equalize the tax burdens between residents and non-residents doing business within the city, nevertheless, the distinction must not reach the point of placing the non-resident at a disadvantage. If so, it will be invalidated as an arbitrary classification.

The Camden supermarket case, already considered on the point of classification, affords as well a good example of an ordinance condemned because confiscatory. The tax imposed in that case was $10,000 per year with a provision for a fine of $200 or

[35] City of Atlanta v. Georgia Milk Producers Confederation, *supra* note 23; and see also note 19, *supra*.

[36] *Supra* note 33, at 599, 42 P. (2d) at 169.

[37] *Supra* note 8. The ordinance described the method of doing business which was to be taxed as "self service in such a manner that purchasers are invited and permitted to make selections of food or merchandise on open display and to place their selections for purchase into baskets, carts, or containers provided by the seller, which are then taken to a counter where a cashier checks the merchandise, places it in bags, cartons, or containers and receives a payment from the customer." The opinion of the court describes the method of doing business of several of the chain stores operating supermarkets. In addition to the A&P these operators were Acme Markets, Inc., The Giant Tiger Corporation of Camden, and The Food Fair, Inc.

[38] *Supra* note 8, at 18. *Cf.* Great Atlantic and Pacific Tea Co. v. Grosjean, 301 U. S. 412 (1937).

imprisonment not exceeding 90 days or both upon a conviction for violation of the ordinance. In determining the question of validity the court admitted and considered evidence as to the matters presented to the city council at a public hearing held before the adoption of the ordinance. The court also observed that while there was no limit on the amount of the tax which the city could levy, on the basis of the present rate of profit a business of $19,000 a week would be required to meet the tax and none of the stores in the chain did any such amount of business.[39] An ordinance of Augusta, Georgia, was also recently invalidated on the ground that it was unreasonable, arbitrary and confiscatory. The court held that the ordinance was not discriminatory as a violation of the uniformity rule, but that it was confiscatory as amounting to a destruction of a lawful business by use of the taxing power.[40]

Approach to the matter of confiscatory taxation from the point of view of reasonableness is to be found in the case of *Great A&P Tea Co. v. City of Columbus.*[41] The court said:[42]

> Legislative powers conferred by charter provisions upon a municipality are not to be measured by the more extensive powers of the State legislature. . . . One requirement of all municipal ordinances is that they must be reasonable, and the courts must declare void an ordinance found unreasonable. . . . This record does not present a case where the city has attempted under its police power to regulate the business affected by the tax ordinance. . . . While the city produced evidence which tended to show that the increase of chain stores in Columbus had had the effect of driving a much larger number of independent stores out of business, yet such evidence could not possibly illustrate any issue which the court is called upon to decide in the present case. . . . We do not mean to imply, however, that the receipts and the profits of the store, standing alone, although the tax completely consumes such profits, will suffice to show that the tax is unreasonable and void. But proof that the tax consumes the entire profits of the stores, coupled with evidence of the prevailing conditions in the city as a whole, showing that these profits are equal to the average in similar businesses, will demand a finding that the ordinance is unreasonable.

Thus although the power to tax is expressly granted, the above limitation on the manner of its exercise presents a question for judicial inquiry into a kind of "reasonableness" usually permissible where the ordinance does not follow a specific formula prescribed by statute but represents in effect a choice of means. As previously indicated, the question of the reasonableness of ordinances as an exercise of existing delegated power constitutes a second legal principle to be considered in weighing the legality of municipal barrier legislation. The doctrines adhered to by the courts in the administration of this principle are these: If an ordinance is adopted pursuant to a specific delegation of power from the legislature and precisely carries into effect the power granted, the local law will be accorded the same presumption of validity as is the state law itself; judicial inquiry into the reasonableness of the ordinance is precluded. The only matter open for judicial review in such a case is the

[39] See digest of brief for the city in the case of The Great A&P Tea Co. v. Atlantic City, N. J., in the New Jersey Supreme Court, (1939) 4 MUNICIPAL LAW J. 21.

[40] City Council of Augusta v. Southern Grocery Stores, Inc., *supra* note 25.

[41] *Supra* note 25.

[42] *Id.* at 466, 468, 470, 6 S. E. (2d) at 324, 326.

question of the existence of local power to adopt the ordinance and that of constitutionality or conformity to general state law. If, on the other hand, the ordinance is adopted pursuant to implied local power or represents a choice of means for invoking an express power, then the reasonableness of the ordinance is a justiciable question.[43] The judicial inquiry in this connection is a matter of determination of fact from the nature of the ordinance as it is drawn and from evidence which may be presented as to its operation and effect.

In no case does the court admittedly consider the motive of the council in adopting an ordinance, aside from a substantiated charge that the ordinance is arbitrary, capricious and an abuse of power.[44] It is settled beyond any possibility of dispute that the matter of the wisdom or the policy of a local law, as well as any other legislative act, is a matter for the exclusive determination of the legislative body and not for the courts.[45] For this reason the particular problem considered here, the use of an existing local power for the purpose of erecting barriers to free markets, is many times beyond judicial scrutiny. As a practical matter, however, the economic effect and operation of an ordinance may be proved without examination of the motive for its adoption. Furthermore, if an ordinance can be shown to have a particular unsound or undesirable effect in operation, it is certainly permissible to show that that effect was the one intended by the council.[46] Consequently, it is frequently permissible and advisable to present evidence of the intention of the council and of the interests actually involved in the adoption of an ordinance, not for the purpose of impeaching its validity, but for the purpose of substantiating the attack based on some other ground.[47]

Judicial administration of the requirement of reasonableness in the case of regulatory as distinguished from tax measures is typified by instances concerning legislative favoritism in products and method of doing business. It is arguable, of course, that the sale of articles by the use of vending machines requires a peculiar type of regulation in order to insure against the sale of tobacco to minors and to guard against possible abuses resulting from the automatic feature of the sale. It is generally conceded that even a prohibitory regulation against the use of vending machines for certain purposes is valid. For instance, in the City of Red Cloud,

[43] Note 18, *supra*.

[44] S. S. Kresge Co. v. Couzens, 287 N. W. 427 (Mich. 1939); see also N. J. Good Humor v. Board of Comm'rs of Bradley Beach, 11 A. (2d) 113 (N. J. 1940): "It is therefore evident that the challenged municipal action was dictated by a purpose to shield the local shopkeepers from lawful competition, and thus to serve private interests in contravention of common rights; and so it must be condemned as an abuse of the police power, and therefore ultra vires."

[45] Thus it is said in Kroger Grocery and Baking Co. v. City of St. Louis, *supra* note 24, at 72, 106 S. W. (2d) at 438: "It is the tendency of commerce to magnify the importance of the quantity of trade; of society (we use the term in its broad sense) to magnify the importance of life, liberty, human happiness, and the quality of men. Motives attending the enactment of legislation in the furtherance of either objective may be most creditable and when on proposed legislation the two interests conflict, it is for the legislative branch of government, acting within its proper scope, not the judiciary, to choose between the conflicting values and determine the policy of the law. We deal only with the power of the city of St. Louis, not the expedience, wisdom, or justness of the license imposed."

[46] Southern Linen Supply Co. v. City of Corbin, 272 Ky. 787, 115 S. W. (2d) 321 (1938).

[47] See note 44, *supra*.

Nebraska, an ordinance prohibiting the operation of vending machines for the retailing of gasoline was held valid.[48]

On the other hand, the City of Chicago was unsuccessful in its attempt to exclude paper containers from the local market area by invocation of the police power relating to public health. It was seriously contended that the paper containers were unsanitary and as a matter of fact liable to contaminate the milk. The ordinance was sustained against attack by the company producing the container-making machinery and by the manufacturer of the containers themselves on the ground that these persons had no proper interest in the application of the ordinance, as it did not operate directly on them but rather on the consumer of the paper bottles.[49] Upon attack by a milk distributor, however, seeking approval by the Board of Health of the distribution of its product in the paper containers, the ordinance was invalidated as an unreasonable exercise of local police power, not shown to be properly related to the protection of public health.[50]

The problem of the relation of local tax measures to interstate commerce is essentially not different from the general relation of state laws to the same subject. For this reason no attempt will be made here to do more than indicate the parallel situation.[51] The recent decision of *Best & Co. v. Maxwell*[52] points out that the commerce clause of the United States Constitution forbids any discrimination against an interstate transaction. In that case the statute required a $250 license of a nonresident merchant displaying goods for sale by sample in any hotel room or temporary quarters whenever he did not maintain a regular place of business in North Carolina. The Court interpreted the recent decision of *McGoldrick v. Berwind-White Coal Mining Co.*[53] as authorizing local sales taxes on interstate transactions only where the tax did not operate to discriminate against the out-of-state dealer. Municipalities as well as states have, in innumerable instances, enacted local tax measures for the purpose of discouraging out-of-state dealers doing a direct sales business by means of canvassers or drummers.[54] While *Robbins v. Shelby Taxing District*[55] has, by the *Berwind-White* case, been limited strictly to the situation of a fixed discriminatory license tax, nevertheless, the rather unrealistic distinction between canvassers and peddlers which had been made since the *Robbins* decision seems still to obtain.[56] The general tenor of the *Berwind-White* case might be interpreted as a resort to a practical test of discrimination, so as to sustain a tax on an interstate transaction provided it appears to be an equalizing measure and not a discriminatory effort. Applied in the particular case to a transaction after an inter-

[48] Hawkins v. City of Red Cloud, 123 Neb. 487, 243 N. W. 431 (1932).

[49] Ex-Cell-O Corp. v. City of Chicago, *supra* note 9.

[50] Fieldcrest Dairies, Inc. v. City of Chicago, *supra* note 9.

[51] *Cf.* note 19, *supra.*

[52] 311 U. S. 454 (1940).

[53] 309 U. S. 33 (1940).

[54] In McGoldrick v. Berwind-White Coal Mining Co., *supra* note 53, the Court noted that several hundred such ordinances are in effect. See the *Robbins* case, *supra* note 19, and Real Silk Mills v. City of Portland, 268 U. S. 325 (1925).

[55] *Supra* note 19.

[56] Singer Sewing Machine Co. v. Brickell, 233 U. S. 304 (1914); Wagner v. Covington, 251 U. S. 95 (1919).

state transit, its principles might easily be extended to a transaction preceding shipment.[57]

Indeed, the fundamental principle implicit in not only the *Berwind-White* case but also *South Carolina Highway Department v. Barnwell Brothers*[58] may be stated in terms of an underlying doctrine or approach which applies equally to judicial examination of local legislation affecting non-residents, regardless of the federal constitutional question involved in state or local legislation affecting interstate commerce. In the *Berwind-White* case is the statement:[59]

> Lying back of these decisions is the recognized danger that, to the extent that the burden falls on economic interests without the state, it is not likely to be alleviated by those political restraints which are normally exerted on legislation where it affects adversely interests within the state.

This statement might easily be formulated into a generalization as to the tenor of judicial inquiry wherever a problem of geographical representation and legislative action is presented, provided, of course, a proper basis for judicial action is laid. Thus enlarged, the principle would be applicable to the problem of the effect on non-residents of local laws having no interstate aspect whatsoever. It may easily be said that roughly speaking such a situation presents the same danger of local legislative action affecting extra-mural interests to which it is in no way responsible or responsive. To be sure, the municipality is a creature of the state and a measure of control may be exerted by resort to the state legislature. But with respect to a matter of local concern in a home-rule jurisdiction no state legislative power exists, and, practically speaking, such as may exist in non-home-rule states is many times inconsequential or ineffective. The courts should have this broad precept in mind when passing on the legality of a local ordinance with respect to its effect on non-residents, whether they be within or without the particular state.

At least one instance is recorded of judicial invalidation of an ordinance found upon proof to be so administered as to operate as an effective prohibition against a non-resident doing business within the municipality. An occupational license tax for revenue purposes was duly authorized as applied to a linen-towel service business.[60] The tax for the privilege of conducting such a business within the municipality by any person was $200. No provision in the ordinance itself disclosed any discrimination or even difference in its application to residents and non-residents. One company located outside the city of Corbin, Kentucky, conducted a business of this type servicing several nearby municipalities. The $200 fee was exacted from it and the company brought suit in the Kentucky courts complaining of the ordinance. On the trial the plaintiff showed that the license tax not only would so operate as to absorb more than the profit from his business done within the City of Corbin, but also that the only resident competitor likewise subject to the ordinance was charged but $40 for his license fee. The resident operator testified,

[57] Lockhart, *State Tax Barriers to Interstate Trade* (1940) 53 HARV. L. REV. 1253, 1275.

[58] 303 U. S. 177, 185 (1938).

[59] *Supra* note 53, at 47, n. 2.

[60] Southern Linen Supply Co. v. City of Corbin, *supra* note 46.

moreover, that the $200 fee would amount to more than any of the profits which he made from the business. Fees charged by the neighboring municipalities were about $25. The court, in allowing the injunction against the enforcement of the ordinance, held not only that the fee exacted was confiscatory but also that it had been proved by the evidence that the ordinance was passed to prohibit the business of a non-resident.

An Illinois sustainment of an ordinance licensing and regulating automatic vending machines, though the law required that licensees be either residents or maintain a business address in the city,[61] introduces the problem of non-resident discrimination in regulatory ordinances adopted pursuant to the police power. The reported decisions are in hopeless conflict. Again the problem involves the attempt to exclude non-residents, the closely related problem of the attempt to exercise extra-territorial power, or an attempt by a local law to regulate a matter of interstate commerce. Many cases indicate no distinction between the revenue or police power purposes of a local law and most license ordinances are phrased in such a way as to invoke either or both sources of local power. A distinction does exist in that a revenue power may be invoked for the purpose of its resultant economic regulatory effect whereas an implied police power may not be employed to produce revenue as such, since power to tax must be express. Since the regulatory aspect is the important element here, the distinction should not be of great significance except in so far as the necessity for express authority to enact a revenue tax suggests a more limited scope of extra-mural impact as compared to the broad possibilities from exercise of implied police power. A rational approach should allow the local measure to stand, in spite of an incidental effect on these three phases of geographical limitation, as a police regulation if there is a reasonable relation in fact between the ordinance and local health, morals, safety, or general welfare, or as a revenue tax if it is expressly authorized and is not discriminatory or confiscatory.

Many decisions fail to take this rational view and unnecessarily restrict and hamper the scope of local ordinances. It has been held that a city has no power to require a non-resident to pay a tax or license fee for the use of a motor vehicle within the city limits.[62] In *C. D. Kenny Co. v. Town of Brevard*,[63] an ordinance taxing wholesale merchants, not otherwise taxed, who used city streets for delivery of goods by truck was held invalid and discriminatory as between resident and non-resident wholesale merchants. The court said:[64]

> The erection of trade barriers between cities and towns by the power of taxation may not be extended beyond constitutional and statutory limits.

[61] Larson v. City of Rockford, 371 Ill. 441, 21 N. E. (2d) 396 (1939).

[62] City of Flora v. Borders, 342 Ill. 208, 173 N. E. 784 (1930). *Contra:* Johnson v. City of Paducah, 147 S. W. (2d) 721 (Ky. 1941); but see Davis v. Pelfrey, 147 S. W. (2d) 723 (Ky. 1941) (distinguishing the *Johnson* case to reach an opposite result).

[63] 217 N. C. 269, 7 S. E. (2d) 542 (1940); see, however, Sivertsen v. City of Menlo Park, 109 P. (2d) 928 (Cal. 1941).

[64] *Id.* at 273, 7 S. E. (2d) at 544.

But on the other hand, a municipality does have the power to regulate the sale and distribution of food and to provide for its inspection in the interest of public health.[65] In the exercise of this power, an ordinance requiring a license of every vehicle used for the storage or carrying of food in the city except those delivering from duly licensed food-dealing establishments was held equally applicable to both residents and non-residents.[66] Some courts have looked with favor upon ordinances requiring a license tax from a person doing business by means of motor vehicle within the municipality where the operator located outside the city conducts a regular system of delivery to customers within.[67] It has been suggested, however, that in California an ordinance imposing a tax on vehicles should be made a constituent part of the general business license ordinance and not a separate ordinance taxing motor vehicles.[68]

In general it may be said that no discrimination under police or taxing power may be directly made against non-residents as an end in itself.[69] Yet wherever any ordinance relates to the nature of the business transacted or the manner of conducting business within the municipality, and that business by virtue of either its character or the manner of its conduct requires special regulation, equalizing regulations against non-residents may properly be made.[70]

The exercise of police power by a municipality must in the absence of an express delegation from the legislature be restricted to the territorial limits of the city. The problem of the non-resident vendor who brings food products manufactured outside the city within the local territory for sale has therefore perplexed the municipalities as to means of properly protecting the consuming public by insuring that those products are pure, unadulterated, and fit for human consumption. In the case of a bakery located outside the city limits supplying local stores with products for sale to the local inhabitants, a move to apply the local ordinance authorizing the city health officer to inspect bakeries and to charge an inspection fee was held void as an attempt to exercise extra-territorial jurisdiction.[71] As already remarked, it would seem that the rational solution should call for a recognition of valid exercise of

[65] Food Stores, Inc. v. City of Tulare, 12 Cal. (2d) 324, 84 P. (2d) 140 (1938); Dorsa v. Santa Clara County, 23 Cal. App. (2d) 217, 72 P. (2d) 912 (1937).

[66] American Baking Co. v. City of Wilmington, 370 Ill. 400, 19 N. E. (2d) 172 (1938).

[67] The Emporium v. City of San Mateo, 177 Cal. 622, 171 Pac. 434 (1918). See also California Fireproof Storage Co. v. City of Santa Monica, 206 Cal. 714, 275 Pac. 948 (1928); Crosswell and Co. v. Bishopville, 172 S. C. 26, 172 S. E. 698 (1934).

[68] Burke, *Licensing the Transient Merchant—So What?* (July 1934) WESTERN CITY MAG. 13-14.

[69] *In re* Hart, 36 Cal. App. 627, 172 Pac. 610 (1918); City of Watertown v. Rodenbaugh, 98 N. Y. Supp. 885 (1906); City of Saginaw v. Saginaw Circuit Judge, 106 Mich. 32, 63 N. W. 985 (1895).

[70] American Bakeries Co. v. City of Huntsville, 232 Ala. 612, 168 So. 880 (1936); American Bakeries Co. v. City of Sumter, 173 S. C. 94, 174 S. E. 919 (1934), *appeal dismissed,* 293 U. S. 523 (1934) (higher fee charged non-resident justified as representing the higher cost of investigating his reputation, etc.). See also State *ex rel.* v. Wagner, 77 Minn. 483, 80 N. W. 633 (1899); *Ex parte* Wade, 146 S. W. 179 (Tex. Crim. App. 1912); MCQUILLIN, MUNICIPAL CORPORATIONS (2d ed. 1928) §828. For a survey of the content of local ordinances adopted for the protection of the local public by requiring registration, photographs, fingerprints, bonds, and a period of time before issuance of a license to non-residents, see (1940) 5 MUNICIPAL LAW J. 47.

[71] *Ex parte* Ernest, 136 S. W. (2d) 535 (Tex. Crim. App. 1940).

local regulatory power if the extra-territorial effect of the regulation is reasonably incidental to necessary police power and the effect on residents and non-residents is the same.[72] Perhaps the leading case in recent years agreeing with the rigid viewpoint of the Texas case above cited is that of *City of Rockford v. Hey*,[73] holding that the City of Rockford had no power to subject ice cream factories located outside the city to inspection as a condition to the permission of the sale of ice cream within the city. In the *Rockford* case, however, it should be noted that the manufacturer was licensed by the state.[74]

A distinction readily suggests itself between non-residents doing business within the local area, who should naturally be subjected to the same regulations applying to inhabitants, and an attempt on the part of the city to exercise its powers outside the city limits. In either case, however, where the reasonable object of the ordinance is to protect the inhabitants, by an exercise of police power properly related to the end to be attained, and there is no evidence of an arbitrary attempt to exclude non-residents or usurp power beyond the local jurisdiction, the ordinance should be sustained.

Operating most heavily against non-residents is the Green River type of ordinance aimed at the direct sales technique of the house-to-house canvasser. Adopted by over 400 cities from 1935 to 1939, this enactment is a simple prohibition of solicitors, peddlers, hawkers, and itinerant merchants from going upon the premises of private residences for the purpose of either peddling or soliciting without having been requested or invited by the occupants. In addition to the problems relating to interstate commerce and extra-territorial effect of such ordinances discussed above, these regulations involve the question of the validity of such a prohibition by the local authority. While the local authority, even under the police power, cannot prohibit a lawful business, it may declare to be a nuisance and prohibit any business or method of doing business which is in fact a public nuisance. A case can be made out sustaining the nuisance character of house-to-house sales methods; nevertheless, it is debatable whether or not this nuisance is public or private. The local police power to prohibit is naturally confined to public nuisances. The original Green River ordinance was sustained in the case of *Town of Green River v. Bunger*,[75] but similar enactments have been invalidated in the states of Oklahoma, Florida, South Carolina, Virginia, Maryland, Georgia, and Nebraska.[76] Because of

[72] See City of Norfolk v. Flynn, 101 Va. 473, 44 S. E. 717 (1903). *Accord:* Wright v. Richmond County, 182 Ga. 651, 186 S. E. 815 (1936); American Baking Co. v. City of Wilmington, *supra* note 66; State *ex rel.* Hogan v. Spencer, 139 Fla. 246, 190 So. 506 (1939); Langs Creamery, Inc. v. City of Niagara Falls, 231 N. Y. Supp. 368 (1928); Whitt v. Climm, 97 Cal. App. 131, 274 Pac. 1039 (1929); Gilchrist Drug Co. v. City of Birmingham, 234 Ala. 204, 174 So. 609 (1937).

[73] *Supra* note 10.

[74] *Ibid. Accord:* Grant v. Leavell, 259 Ky. 267, 82 S. W. (2d) 283 (1935); Miller v. Williams, 12 F. Supp. 236 (D. Md. 1935); State v. Minneapolis, 190 Minn. 138, 251 N. W. 121 (1933).

[75] *Supra* note 7. A recent case in accord is *Ex parte* Lewis, 147 S. W. (2d) 478 (Tex. Crim. App. 1941).

[76] See (1940) 5 MUNICIPAL LAW J. 23, 46, 84, and cases collected in *Report of the Committee on Ordinance and Ordinance Enforcement*, in MUNICIPALITIES AND THE LAW IN ACTION (Nat. Inst. Mun. Law Officers, 1940).

the debatable ground on which these ordinances are based their economic effect as market barriers may well be considered by the courts as well as by the local city council.

Finally, a form of local barrier law may be found in the general tendency in local affairs to give preference to local labor or local products in government purchases or construction. These ordinances have taken the form of direct residence or citizenship requirements and are generally free from any attack based on federal constitutional limitation. In New York it has recently been held that a three-year residence requirement to establish eligibility for local civil service employment is valid.[77] In the conduct of local government business the municipality and the state alone are concerned.[78]

While it is beyond the scope of this discussion to propose any concrete solution for market-barrier evils arising from local legislation, it may be suggested that as a general rule the economic desirability of the local ordinances, in so far as they operate on local groups, may be safely left as a matter for the exclusive jurisdiction of the city council, which, at least theoretically, represents all interested and affected persons. In the case of local legislation which by design or effect sets up a tariff wall around a local marketing area to insulate it from traders from other parts of the country, a problem of importance to the national unity is presented and requires attention beyond that likely from the local enacting body. The courts in review of such local laws may be addressed upon matters of reasonableness, arbitrary classification, extra-territorial operation, or discrimination against interstate commerce, in accordance with the principles above illustrated. Wherever such judicial inquiry will prove ineffective, congressional action may in some measure be effective. On the other hand, a note of warning might well be sounded in view of the extensive literature which is rapidly growing up in this field, and in view of the intensive drive toward national unification of all economic resources as a defense measure. The study of the barrier effect of local as well as state legislation should not be allowed to develop into a witch hunt which would tend to distort and proscribe many forms of reasonable and necessary local equalizing laws, or necessary protective measures enacted in the course of the exercise of legitimate police power.

[77] Mullins v. Kern, 280 N. Y. 543, 20 N. E. (2d) 10 (1939).

[78] Patsone v. Pennsylvania, 232 U. S. 138 (1914); McAllister, *Court, Congress and Trade Barriers* (1940) 16 IND. L. J. 144, 164-165.

ADMINISTRATIVE MARKETING BARRIERS

FRANK BANE*

An examination of statutory barriers to market access, while affording an understanding of legislative determinations of general policy, leaves out of account the potentialities of administrative action for the creation of marketing barriers. These potentialities will frequently precipitate actual interference as the result of retaliatory action, the variance in regulations from state to state, lack of trained administrators, overzealousness in some instances, and occasionally political favoritism.

INTERSTATE TRADE BARRIERS

In international parlance, the terms "indirect protectionism" and "administrative protectionism" are well understood. They have been defined as including "all measures of other than legislative origin, whether originating with ministerial, regulative, or administrative branches of governments which in their purpose, or in their effect, tend unreasonably to hamper the movement of international trade and to afford additional protection to producers, beyond the degree definitely prescribed or contemplated by the basic tariff regulations of the country." So in the national and municipal areas administrative action resulting from the grant of wide discretion to the enforcement officers and action extending beyond statutory authorization has perhaps been more often used for protecting local products and enterprises from out-of-state competition than has purposeful legislation. The ease and rapidity with which administrative action may be employed and the routine character of its application make trade barriers created under it difficult to discover and correct. Thus, state laws which provide for legitimate exercise of police powers may be so administered as to interfere with interstate commerce. This international analogy with its definition of administrative protectionism, when paraphrased to apply to the interstate situation, is, however, too limited and must necessarily be broadened to include instances of broad grants of discretionary powers where administrative action may be said technically to be contemplated by the basic statutory regulations of the state.

Administrative regulations which constitute barriers to the interstate movement of goods have thus far not received detailed attention from students of the trade barrier problem. Until this evidence is available, it will not be possible to assess

* A.B., 1914, Randolph-Macon College. Executive director, Council of State Governments. Lecturer on public welfare administration, University of Chicago; executive director, Social Security Board, 1935-1938. Contributor to periodicals.

with certainty the proportion of trade barriers which have developed from the abuse of administrative discretion. The present discussion is based primarily on official complaints which have reached the Council of State Governments through the various state Commissions on Interstate Cooperation.

Restrictions on the Entry of Goods Into the Market

The milk industry has been a particularly fertile field for the establishment of trade barriers by administrative action and serves as an excellent example of the control that may be exercised through the device of inspection under color of a public health measure. Investigation by the Indiana Commission on Interstate Cooperation shows that in many instances the restrictions by the East upon the importation of Midwestern dairy products have been through administration of the regulations rather than by following the letter of their texts. The usual situation might be described as one in which an Eastern community will permit the importation of any dairy products which meet its sanitary requirements; however, it alone must be the judge of the purity of such imported products; it, the community, has a more competent, more highly trained, more skillful corps of inspectors than any other unit of government—inspectors who, alone, know what products will meet the health requirements of the community; however, they regret that it is physically and financially impossible for their corps of inspectors to make a complete tour of inspection of farms and herds in Illinois, Indiana, Kentucky, Michigan, Minnesota, Ohio, Tennessee, Wisconsin; and therefore, of necessity, their inspection, like charity, must begin at home. Of pertinent interest is the further evidence collected by the Indiana Commission that inspections beyond the confines of a limited area are made only in times when there is a shortage of the local supply.

Other authorities, suggesting that Indiana might first put its own milk house in order, offer in rebuttal evidence showing that Indiana cities discriminate in the same way against milk shipped in from other milk sheds *within* the state but not immediately adjacent to the city.

Aside from the fact that recognition is not extended to the validity of inspection certificates issued by the producing states, the entry of goods into the market is similarly affected by diverse regulations with respect to labeling requirements. A regulation adopted by the Dairy and Food Commission of Connecticut requires cartons containing butter to which color has been added to bear as part of the label, the words "artificially colored." Connecticut is the only state having such a requirement and butter is specifically exempted by the Federal Government from food required to be so labeled. Owing to the fluctuating natural color in butter, it has been considered good practice in the industry to maintain a fairly constant color during all seasons of the year. It is significant to note that the Connecticut regulation does not prohibit the use of coloring, nor does it specify any types of coloring which it considers injurious to public health. The regulation becomes a trade barrier in that butter producers have no knowledge of the ultimate destination of butter

manufactured and shipped in large lots. If the industry does not withdraw entirely from the Connecticut market, it is faced with a choice between the expense of segregating shipments destined for that state and labeling cartons in those shipments differently from those used in all other markets, and labeling butter for all markets in such a way as to make it eligible for sale in Connecticut, a step which would put it at a distinct disadvantage for sale in any other market.

The action of Congress in adopting certain provisions of the Agricultural Adjustment Act of 1938 with subsequent amendments, has given rise to additional administrative barriers to the free flow of dairy products from Midwestern to Eastern markets. Without regard to questions of public policy and solely for the avowed purpose of stabilizing the marketing of dairy products in the metropolitan areas of the East, geographic limitations have been arbitrarily placed around production and marketing areas within which prices of dairy products are fixed by public authority. Orders promulgated under authority of this Act of Congress have threatened to put an end to the remaining exportation of cream and milk products from the Midwestern states to the Eastern markets.

Plant quarantine regulations have been administered in many instances in such a way that administrators have been accused of using their powers purely for the sake of erecting barriers. A Special Report of the Bureau of Agricultural Economics in March, 1939, quotes a criticism of the administration of the alfalfa weevil quarantine which is typical of this area of administration:[1]

> It appears that they use this quarantine, which they put on or take off apparently at will, to protect their hay growers in times of low prices or to open a market for the stockmen in times of high prices. That is, if they need (our) native hay or alfalfa in an area of (their State) which cannot be supplied by it, they relax the quarantine measure. If they have plenty of hay, the quarantine is maintained.

These instances of quarantine manipulation and of the artificial methods of maintaining prices affecting the entry of goods into the market indicate the latitude of discretion given to administrative officers. This same latitude with its possibilities of indirect favoritism may be found in the application of the inspection and port of entry laws and other similar ostensible health and police measures.

Restrictions on the Entry of Persons Into the Market

The entry of persons into the market, because of the difficulties of fixing legislative standards of personal qualifications, is to a great extent left in the hands of administrators. Here the administrative discretion is like the Chancellor's conscience which is measured by the length of the Chancellor's foot. The finality of such administrative action is well expressed by the General Counsel of the Securities and Exchange Commission:[2]

[1] Taylor, Burtis and Waugh, *Barriers to Internal Trade in Farm Products* (U. S. Dep't Agric., 1939) 93.

[2] Lane, *Symposium on Administrative Law* (1939) 9 AM. L. SCHOOL REV. 139, at 162.

Candor compels me to admit, however, that the remedy of judicial review, in most cases, has no practical content. Business transactions cannot wait upon the exigencies of appeal. The overwhelming mass of administrative determinations are never reviewed by the courts. Time is of the essence. Even appellate procedure within the administrative body by no means insures that the unfortunate results of action unwise or arbitrary will be cured. The remedy of appeal is not adequate.

The state, in the exercise of its police power, is authorized to subject all occupations to a reasonable regulation where such regulation is required for the protection of public interests or for the public welfare. Pursuant to this principle, laws have been enacted requiring a license or certificate to practice a profession and many other laws have been passed in which the right to engage in a calling or occupation other than a learned profession, is conditioned upon the securing of a license. Illustrations of laws affecting such occupations are: steam engineers, inspection of steam boilers, barbering, nursing, pharmacy, funeral directing and embalming, aircraft piloting, real estate brokerage, and so on. While these provisions affecting entry of persons into occupations apply to persons within the state as well as those out of the state, additional requirements such as residence for a prescribed period are in many cases imposed. This favoritism of the "native" as a declaration of legislative policy, together with the perhaps natural inclination to protect the "home town boys," often results in a strained construction of the provisions with respect to qualifications.

In the case of itinerant truckers, most states do not require a farmer living in an adjoining state to obtain license plates for his truck if he merely uses the truck for the purposes of marketing items produced on his own farm. Administrators have the power, however, in granting the exemption to determine whether the products are in fact produced by the farmer. In many states each case is handled on its merits with no fixed rule regarding the type of proof required. Proofs submitted by farmers in such cases take the form of official grower's certificates, official tax receipts on the land farmed, and registration papers carrying a rural address. Regardless of the type of proof, the administrator may in his discretion refuse to grant the exemption.

Many states have purchase preference statutes requiring that non-resident firms, in order to be eligible for a contract, bid more than three percent beneath the lowest local bid. This statutory trade barrier plus administrative action in refusing to furnish bidder's lists has resulted in discrimination beyond the expressed intent of the legislatures. In the Council of State Governments' drive to eliminate purchase preference laws as a form of trade barrier, information has been forthcoming from some states to the effect that they would be entirely willing to repeal this obvious barrier because the administrative purchasing agent would surely favor his own state.

However, broad as is the latitude granted the administrator and frequent as the instances have been of discrimination against out-of-state products and persons

by administrative action, nevertheless it seems a safe generalization to say that, as a group, experienced administrators are less prone to impose barriers than are those legislators who, in an effort to please local business interests or their constituents, have in the past sought to obtain a legislative declaration of policy in this direction. Fortunately, administrators of the other view are in the minority and are rapidly losing whatever influence they once had.

The motor vehicle administrators have made progress, frequently wiping out state barriers to the full extent that their administrative authority will allow them to do so. In their willingness to destroy barriers they have used silence in the statutes to issue rules and regulations in conformity with the practice of their neighbors. In some cases they have run ahead of legislative intent. For instance, one state four years ago passed a resolution forbidding the motor vehicle administrator from adopting reciprocal regulations. The administrator disregarded the resolution and within a month was forced by statute to refuse any and all reciprocal agreements with neighboring states.

Non-Geographical Marketing Barriers

Marketing barriers are also raised by administrative rulings of a different character. Favoritism of administrators for particular products or methods of doing business apply as well within the state concerned rather than being erected on the state line. This is the most difficult type of barrier to discover and resolves itself into general questions of economic policy. In the administrative field it is, of course, only an expression of a similar economic favoritism established by legislative policy resulting from pressures of economic competitors. The extent of the practice of this type of favoritism by administrators is doubtless widespread. However, there are no means of actually gauging the development, and the citation of sporadic instances is about as far as it is possible to look into the problem at the present time.

State purchasing agents, for instance, are at complete liberty to choose between identical bids which may be submitted by independent retailers, mail-order houses, or chain stores. The extent to which impartiality is shown will depend entirely upon the individual purchasing agent and his resistance to specific pressures which may be brought to bear upon him.

Frequently departmental rulings without statutory basis go unnoticed and unchallenged excepting by the group injured. The Department of Agriculture in one of our Midwestern states recently issued a ruling requiring the use of paint with a soybean oil base on all public buildings in the state. This regulation inevitably called forth an immediate protest from the well-organized industry adversely affected, and the ruling was subsequently revoked. On the other hand, the paint situation typifies the predicament in which new products are likely to find themselves as the result of administrative regulations written at an earlier period of time. Undoubtedly the rulings of numerous states specify that paint on public contracts must contain white lead and linseed oil. Such rulings were probably not inspired by a

desire to advantage linseed oil manufacturers but by the common, and correct, belief that linseed oil was then the best paint oil. But regulations of this character now operate to the disadvantage of the soybean interests, since for many purposes soybean oil is fully equal to linseed in paints. Distributors of prefabricated houses find themselves in a like situation as a result of the fact that most building codes, drafted in the prefabrication era, are not favorable to the construction principles applied in building the made-to-order house. Judging from investigations undertaken by the Department of Justice, there is basis for believing that a hostile administrative attitude often works against the new type of construction where discretion is left to the inspector.

Stringent sanitary regulations governing the manufacture of ice cream by the use of "counter freezers" provide a basis for administrative discouragement or prohibition of the integration of the businesses of manufacturing and selling this product. Here, however, the action taken is largely dictated by the basic legislative provisions the regulatory body is enjoined to enforce. But exercise of administrative discretion not demanded or perhaps even contemplated is to be found in the action of an Eastern milk board in requiring milk dealers selling milk in paper containers to charge one cent more than those selling in bottles. Naturally, such action does not go unchallenged.

Difficult as it is to pin down trade barriers erected by administrative action, and impossible as it is at this time to make a comprehensive list of such walls to the free movement of goods and services, the problem is nothing in comparison with that of tracing these barriers through the semi-administrative, administrative-judicial, and fields controlled by private or semi-public groups. For instance, administrative-judicial interpretation of the Sherman Act has restrained meat packers from selling groceries, while the rival demands of various union labor groups in different parts of the country have made it impossible in some instances for manufacturing companies to fulfill orders. A Detroit manufacturing company has found that in certain Northwestern states electricians will not install lighting fixtures unless they bear A. F. of L. labels, whereas in certain Midwestern states a CIO label is required. Obviously, the manufacturing company cannot satisfy both demands.

This brief appraisal of administrative action creating trade barriers is hardly an approach to the problem. The possibility of abuse necessarily permeates all statutes, for discretion must be granted to permit the proper functioning of government. The answer does not lie in legislative limitation, but in the direction of closer association of administrative officials engaged in the same work from state to state. Herein doubtless lies the success which motor vehicle administrators have had, as well as the notable advances being made in the matter of plant quarantines by the several regional plant boards that are composed of the agricultural administrators of all of the states.

BARRIER ACTIVITIES AND THE COURTS: A STUDY IN ANTI-COMPETITIVE LAW

NATHAN ISAACS*

In 1884 Mr. Justice Field paraphrased the Declaration of Independence and proceeded:[1]

> Among these inalienable rights, as proclaimed in that great document, is the right of men to pursue their happiness, by which is meant the right to pursue any lawful business or vocation, in any manner not inconsistent with the equal rights of others, which may increase their prosperity or develop their faculties, so as to give them their highest enjoyment.
>
> The common business and callings of life, the ordinary trades and pursuits, which are innocuous in themselves, and have been followed in all communities from time immemorial, must, therefore, be free in this country to all alike upon the same conditions. The right to pursue them, without let or hindrance, except that which is applied to all persons of the same age, sex, and condition, is a distinguishing privilege of citizens of the United States, and an essential element of that freedom which they claim as their birthright.

At that very moment state legislatures were instituting a movement to bar many persons from access to the market unless or until they were licensed by the proper authorities. Lawyers, physicians, plumbers, architects, auctioneers, dealers in second-hand goods, pawnbrokers, barbers, druggists, peddlers, liquor dealers, victuallers, accountants, butchers and bakers—these were only the vanguard of trades and professional men so restricted. Within twenty years after Field spoke, an encyclopedia of law was able to enumerate among the persons whose occupations had been declared to be properly subject to license practically every type of businessman operating at the turn of the century.[2] Of course not every one of these businesses had been subjected to licenses everywhere. But if we look into the cases cited to support the inclusion of each type of tradesman in the list, we see a series of little court battles in which men who believed as Field did were beaten one by one, until a revolution had been fought and won by new forces.

* A.B., 1907, A.M., 1908, Ph.D., 1910, LL.B., 1910, University of Cincinnati; S.J.D., 1920, Harvard University. Professor of Business Law, Graduate School of Business Administration and Graduate School of Public Administration, Harvard University. Editor (with Roscoe Pound), THE NATIONAL LAW LIBRARY (1939), and the UNIVERSITY BUSINESS BOOK SERIES. Author, THE LAW IN BUSINESS PROBLEMS (rev. ed. 1934). Contributor to ENCYCLOPAEDIA BRITANNICA (1930), ENCYCLOPAEDIA OF THE SOCIAL SCIENCES (1931-35), and various legal and business periodicals.

[1] Butchers' Union Co. v. Crescent City Co., 111 U. S. 746, 757 (1884). A contemporaneous view strikingly parallel in its attitude is to be found in Chaddock v. Day, 75 Mich. 527, 42 N. W. 977 (1889).

[2] See (1907) 25 CYC. 611-621.

The pioneer stage of American civilization had passed. The state and locality could bar any man's access to the market as a seller of goods or services. It is of course true that its officers had no right to act arbitrarily, and the laws had to have some relation to public health, safety and morals, for licensing laws were regarded as emanating from the police power. But it is also true that licensing officers were and had to be endowed with a broad discretion, which in the absence of manifest bad faith they exercised with finality. That this discretion was frequently abused by dishonest authorities is beyond question. That it was also abused by persons who considered themselves honest and actuated by the highest motives is more important for us at the moment. Almost every extension of the licensing power of a state to a new industry is traceable to the wishes of men in that industry. Many of these have readily believed that they were working for higher standards of training, character and responsibility in their trade or profession. Actually they were at the same time succeeding in keeping the "outs" out, and thus limiting their own competition. Quite generally, men already in the trade or profession were automatically licensed or exempted from the requirement, and the commissioners and examiners entrusted with the bestowing or withholding of the licenses were recruited from these ranks. By raising or lowering standards they could control the numbers of persons given access to the market, and sometimes by requiring various kinds of sponsorship they could discriminate against newcomers, or in favor of apprentices previously approved by their own group, or in favor of certain schools, particularly local schools.

After more than a generation of the assumption of such power by license commissioners, the case of *New State Ice Company v. Liebmann*[3] came as a jolt in 1932. The statute of Oklahoma separated from the actual granting of a license the task of ascertaining whether existing licensed facilities for the manufacture of ice were "sufficient to meet the public needs." The holding of the Court was that certificates of convenience and necessity had no application outside of the realm of public utilities and allied situations. It was remarked in passing that,[4] "The control here asserted does not protect against monopoly, but tends to foster it. The aim is not to encourage competition but to prevent it; not to regulate the business, but to preclude persons from engaging in it." The suggestion that a state has no power to limit competition by limiting access to the market did not go unchallenged. The dissenting opinion of Mr. Justice Brandeis on the need of economic experimentation by the states is notable not only for its economic and political theory, but for its reflection of existing tendencies in other parts of the current law regulating access to markets.

The indulgent attitude of courts has continued in dealing with licensing regardless of the suspicion, cast on many of the laws and their administration, that they had little to do with public health, safety or morals. It is only in extreme cases that the mask has been torn from municipal trade barriers parading as licensing

[3] 285 U. S. 262 (1932).

[4] *Id.* at 279.

laws. A few recent examples on both sides of the line will illustrate the point. In *Real Silk Hosiery Mills, Inc. v. City of Portland*,[5] a license tax imposed on solicitors taking orders for hosiery to be shipped to buyers from another state was held to be an intolerable burden on interstate commerce. In *Saidel v. Village of Tupper Lake*,[6] it was said that if the real purpose of an ordinance was to stifle competition and increase the business of dealers operating stores in a village, the ordinance could not be sustained, although it purported merely to require a license for the soliciting of orders in the village for future delivery of goods. Finally, in the case of *Best & Co., Inc. v. Maxwell*,[7] a state "privilege tax law" embodying the provisions usually found in such licensing ordinances was declared invalid by the Supreme Court. In the course of his opinion, Mr. Justice Reed said:[8]

> In each case it is our duty to determine whether the statute under attack, whatever its name may be, will in its practical operation work discrimination against interstate commerce. This standard we think condemns the tax at bar. . . . Interstate commerce can hardly survive in so hostile an atmosphere.

The decision is all the more illuminating for our purpose because the "ostensible reach of the language" of the statute included local as well as out-of-state merchants who might choose to display samples in a hotel room or similar quarters for the purpose of securing retail orders. The Court detected the actual discrimination concealed under the non-discriminatory words.

The inspection of goods and wares is closely akin to licensing in principle and in the opportunities afforded for abuse. It is, of course, in the main a legitimate means of barring market access to undesirable goods. Apart from administrative abuses tending to favor certain producers, products or localities, inspection laws are frequently connected with certain fees and other expenses that make them prohibitive for some sources of supply. The outstanding examples here are in the dairy industry. If cities may insist on excluding milk or milk products not inspected at the source, if they may charge the outlying dairy the full cost of the time, the mileage and the use of equipment for inspection, they may intentionally or unintentionally be cutting off that dairy from access to the city's market. So far this particular complaint of dairies has not been passed on in the courts. But in *Hale v. Bimco Trading, Inc.*,[9] a Florida statute exacting 15 cents a hundred pounds for the required inspection of all imported cement was held invalid, in view of the immunity of domestic cement from the requirements of the statute and the admission that the fee was sixty times the actual cost of inspection.

A variant of inspection laws and ordinances is found in the sticker ordinances tried in Dayton, Ohio, and some other cities. In *City of Dayton v. Bohachek*[10] the following ordinance was challenged:

[5] 268 U. S. 325 (1925).
[6] 254 App. Div. 22, 4 N. Y. S. (2d) 814 (1938).
[7] 311 U. S. 454 (1940).
[8] *Id.* at 455-456.
[9] 306 U. S. 375 (1939).
[10] 26 Ohio L. Abs. 417 (Ohio App. 1938), appeal dismissed in the Ohio Supreme Court, May 4, 1938.

> It shall be unlawful for any person to sell, exchange or install . . . any fixture . . . whether new or second hand unless the same has securely attached thereto a label or sticker containing thereon the name "City of Dayton," a serial number and the signature of the plumbing inspector of the City of Dayton or facsimile of such signature engraved thereon.

The court placed some reliance upon the unreported Missouri case of *Mound City Plumbing Supply Co. v. Dickman,*[11] which had held an identical St. Louis ordinance unconstitutional. It is not clear on the face of the ordinance nor in the short opinion of the court what was sought to be accomplished or what was feared as a result of this inspection ordinance. Presumably it created the possibility of administrative discrimination against certain products, new or second-hand, or against particular channels of distribution.

The requirement of branding, labeling, or otherwise distinguishing a product has occasionally been resorted to for administrative purposes. But when the requirement goes so far as coloring oleomargine pink or out-of-state milk red, it gives up all pretense of reasonableness.[12]

Several of the cases already cited under licensing and inspection involve also taxation as a method of barring persons or goods from access to the market. Taxation as a means of encouraging or discouraging particular activities is of course nothing new. Nor are the courts so naive as to insist that taxation must be only for revenue. They have tolerated luxury taxes, compensatory taxes, prohibitive or destructive taxes of various kinds. Why not, therefore, taxes calculated to make the market more or less accessible for chosen persons, commodities, localities? The answer is roughly that while taxing is a permissible alternative means of accomplishing lawful ends, it does not open the door for unlawful objectives. If a particular discrimination is prohibited to the state legislature, the fact that it is to be accomplished solely by taxation is of no avail. The difficulty arises in applying this general principle.

Taxation has been resorted to as a means of barring access to the market (1) in the fight among states and localities for business advantages, (2) in the history of chain-store legislation, and (3) in government favoritism in product competition. In the use of taxation in the setting up of interstate barriers, the obvious difficulty encountered has been the interstate commerce clause. The attitude of the Supreme Court on the applicability of this clause has undergone an interesting development. Whether we begin with Marshall's idea that the clause automatically deprives states of all powers to legislate on subjects within the meaning of the term, or with Taney's, that it merely makes congressional action override state action or the possibility of

[11] Decision by Kirkwood, J., Div. No. 3, St. Louis, Mo., cited *id.* at 418.

[12] In the case of Collins v. State of New Hampshire, 171 U. S. 30 (1898), a statutory requirement that oleomargarine sold within the state be so colored was held void as to interstate commercial transactions. Rhode Island's "red milk" is cited in Taylor, Burtis and Waugh, *Barriers to Internal Trade in Farm Products* (U. S. Dep't Agric., 1939) 11; *Hearings Before the Temporary National Economic Committee,* 76th Cong., 2d Sess. (1940) Pt. 29, at 16124, Exhibit 2354.

state action,[13] we reach a point where it becomes necessary to determine what are the subjects of interstate commerce, how long they remain such, and what types of interference by states will not be tolerated.

The judges of the nineteenth century were fond of categorical answers to these questions. They listed the subjects of interstate commerce, they laid down such tests as the original package doctrine, and they made such dogmatic announcements as that of the *Robbins* case,[14] that "Interstate commerce cannot be taxed at all, even though the same amount of the tax is laid on domestic commerce. . . ." From such positions they have now receded. We no longer have a list of subjects of interstate commerce; on the contrary, one and the same activity may be interstate for some legal purposes and intrastate for others.[15] The original package doctrine, applied originally to the local taxation of imports,[16] was shied away from when interstate shipments were held to be neither imports nor exports in the constitutional sense,[17] and today it presents a mere circumstance to be taken together with many other considerations in deciding a question of fact. Finally, the doctrine that interstate commerce cannot be taxed by a state has been abandoned. In 1929, Mr. Justice Stone declared in a concurring opinion that interstate commerce must pay its own way.[18] In 1932, Mr. Justice Holmes repeated the statement in delivering an opinion of the Court.[19] This declaration rendered obsolete a whole beadline of cases in which the nontaxability of interstate commerce was the major premise.[20] It paved the way for property taxes on articles used or moved in interstate commerce,[21] for gasoline taxes,[22] for use taxes,[23] and eventually for sales taxes levied by the state of the buyer.[24] The precise tacking by which the Supreme Court accomplished its change of direction does not concern us here so much as does the fact that there has been a change of direction.[25]

To resist a tax today requires proof of discrimination against interstate commerce, "hostility" to interstate commerce as members of the Court have several times expressed it.[26] There is, however, no assurance that a type of tax considered

[13] See Jackson, *The Supreme Court and Interstate Barriers* (1940) 207 ANNALS 70-72.

[14] Robbins v. Shelby County Taxing District, 120 U. S. 489, 497 (1887).

[15] Virginia Ry. Co. v. System Federation No. 40, 300 U. S. 515 (1937).

[16] Brown v. Maryland, 12 Wheat. 419 (U. S. 1827).

[17] Woodruff v. Parham, 8 Wall. 123 (U. S. 1869). *Cf.* Powell, *New Light on Gross Receipts Taxes* (1940) 53 HARV. L. REV. 909, 935.

[18] Helson *et al.* v. Kentucky, 279 U. S. 245, 253 (1929).

[19] New Jersey Bell Telephone Co. v. Tax Board, 280 U. S. 338, 351 (1930).

[20] Not quite obsolete for, oddly enough, these cases are cited when abuse of the power to tax interstate commerce is in question, as in the case of Best & Co., Inc. v. Maxwell, *supra* note 7. For a collection of the cases, see Lockhart, *The Sales Tax in Interstate Commerce* (1939) 52 HARV. L. REV. 617, 618, n. 10.

[21] Wiloil Corp. v. Pennsylvania, 294 U. S. 169 (1935).

[22] Gregg Dyeing Co. v. Query, 286 U. S. 472 (1932).

[23] Henneford v. Silas Mason Co., 300 U. S. 577 (1937).

[24] Sears, Roebuck v. McGoldrick, 279 N. Y. 184, 18 N. E. (2d) 25 (1938); McGoldrick v. Berwind-White Coal Mining Co., 309 U. S. 33 (1940); Nelson v. Sears, Roebuck & Co., 61 Sup. Ct. 586 (1941).

[25] See William B. Lockhart's comprehensive studies on *The Sales Tax in Interstate Commerce*, *supra* note 20; and *State Tax Barriers to Interstate Trade* (1940) 53 *id.* 1253.

[26] *E.g.*, in Best & Co., Inc. v. Maxwell, *supra* note 7, and in the opinion of Justices Black, Frankfurter and Douglas in McCarroll v. Dixie Greyhound Lines, 309 U. S. 176, 183 (1940).

"hostile" in one case will always be so treated. Among the taxes recently condemned are the following: a gasoline tax said by the Court to fall directly on the use of a ferry in interstate commerce;[27] a statute taxing all gasoline in excess of twenty gallons carried by a car entering a state, regardless of the actual road use contemplated within the state;[28] and the North Carolina tax on the user of a hotel showroom.[29] And among the taxes found innocent are these: a use tax on goods brought into the state and stored there;[30] the mail-order tax on goods brought into the buyer's state;[31] the sales tax on coal shipped into New York City;[32] the sales tax on goods ordered in New York City and sent in from out-of-state warehouses where they had been stored for the convenience of the dealer;[33] the tax on goods bought and delivered within a state where it was a matter of indifference so far as the contract of sale was concerned whether they came in from out of the state or not;[34] a tax on storage and withdrawal of oil that had been brought in from outside of the state;[35] and a tax on gasoline sold to an interstate air liner.[36]

Sales taxes and use taxes have so far been carefully drawn in order to subject goods brought into the state to the same tax paid by domestic goods sold within the state. Of course if we look at the specific facts in any case we may find double taxation. Double taxation, however, is not in itself unconstitutional. It is desirable, of course, to avoid it—and legislatures as well as courts have tried to do so. But so long as imported goods are not subjected to a heavier tax in the buyer's state than that on domestic goods, there seems to be no constitutional ground of complaint. The same logic might be applied to sales taxes in the seller's state levied on goods shipped out of it in interstate commerce. It is not likely to be, because a tradition has already been established of regarding these taxes as taxes on the buyer. Viewed as such, they are beyond the reach of the seller's state.[37]

The study of a trend of legal decisions is never free from a consideration of the personal attitude of judges, particularly, in constitutional questions, of the justices of the Supreme Court of the United States. A school of law has grown up that seeks an underlying unity in the judicial pronouncements and writings of each judge. There is, of course, a good deal of danger in basing one's conduct on provisos drawn up on such a basis. By no means all arguments of counsel are predestined to fall on deaf ears. Judges themselves sometimes change their approach and at other times, without attempting any change of approach, draw remarkable distinctions. They are no more bound than any other human being to pursue to

[27] Helson *et al.* v. Kentucky, supra note 18.

[28] McCarroll v. Dixie Greyhound Lines, *supra* note 26.

[29] Best & Co., Inc. v. Maxwell, *supra* note 7.

[30] Southern Pacific Co. v. Gallagher, 306 U. S. 167 (1939).

[31] Nelson v. Sears, Roebuck & Co., *supra* note 24.

[32] McGoldrick v. Berwind-White Coal Mining Co., *supra* note 24.

[33] Sears, Roebuck v. McGoldrick, *supra* note 24.

[34] Wiloil Corp. v. Pennsylvania, *supra* note 21.

[35] Nashville, Chattanooga & St. Louis Ry. v. Wallace, 288 U. S. 249 (1933).

[36] Edelman v. Boeing Air Transport, Inc., 289 U. S. 249 (1933).

[37] O'Kane v. New York, 283 N. Y. 439, 28 N. E. (2d) 905 (1940). See Note, *Validity of Sales Tax by Seller State on Interstate Transactions* (1940) 26 CORN. L. Q. 158; (1941) 9 DUKE BAR ASS'N J. 54.

logical conclusions all the theories they profess. There is no clear majority in the present Supreme Court on any major issue with the possible exception of the controlling one: that it is a question of common sense in each case whether a particular burden imposed on interstate commerce is primarily and essentially a barrier or only incidentally and accidentally such. In other words, there is no majority on the question whether it makes a difference that the goods are at the time of the imposing of the burden outside of the state. There is no clear majority on whether it makes a difference that there is a necessary contemplation that goods will be brought across state borders in the fulfillment of the contract. There is no majority on the question whether the buyer's state need pay any attention to what happens in the seller's state or whether they are to be dealt with on the same principles or on different principles. The grouping of the justices, particularly on the basis of *McCarroll v. Dixie Greyhound Lines,*[38] while interesting, therefore seems to have been somewhat overemphasized as an indication of the trend. What is more important at the moment is the obvious necessity for courts, legislatures, and administrators alike to recognize the increasing need for taxation and regulation and the necessity of making some reasonable compromise between the interests of the people as citizens of the states and of those same people as citizens of the United States in keeping the channels of interstate commerce open without draining those of intrastate commerce.

Taxation, we have said, has been used in the fight against chain stores. The story has been told in detail elsewhere.[39] We are concerned here merely with one aspect of the judicial reaction to such efforts. If certain crudities and technical collisions with state constitutions are avoided, taxation can be used as a heavy weapon against chain stores, or any other singled-out variety of store, such as the supermarket or the department store.[40] It is curious to contrast the boldness of taxation experiments in this connection, with the conservatism of use tax legislation. The Camden basket law[41] which penalized self-service stores in which baskets were supplied for the convenience of shoppers may be an extreme instance. Courts still have much of the task before them of drawing the line between allowable and purely arbitrary taxes that discriminate against the too-powerful competitor.

Taxes have been used to favor particular products and to keep others from the market. The outstanding cases come under the oleomargarine laws of dairy states and the retaliatory legislation of states producing particular vegetable oils. The *Magnano* case[42] seemed to put the stamp of approval on this type of legislation. What it really decides in law may be more fairly stated as the propriety of such

[38] *Supra* note 26.

[39] Feldman, *Legislative Opposition to Chain Stores and Its Minimization, supra* this issue.

[40] The series of cases establishing the general principle include: State Tax Comrs. v. Jackson, 283 U. S. 527 (1931); Fox v. Standard Oil Co., 294 U. S. 87 (1935); Great A. & P. Tea Co. v. Grosjean, 301 U. S. 412 (1937). Liggett Co. v. Lee, 288 U. S. 517 (1933), is an illustration of an arbitrary and hence unconstitutional mode of calculation of the tax.

[41] Great A. & P. Tea Co. v. Com'rs, 122 N. J. L. 47, 4 A. (2d) 16 (1939).

[42] A. Magnano Co. v. Hamilton, 292 U. S. 40 (1934).

legislation in the absence of an illegal motive and the presumption of the absence of illegal motives in a legislative body. These propositions of law are unimpeachable, but there is still a valid question as to how blind a court should be to what everyone else can see. It seems probable that a court is more likely to indulge in the presumption of regularity and legality of object when a commodity discrimination is involved than when a purely personal discrimination is presented.

Particularly difficult will be the lot of the manufacturers and sellers of intoxicating liquors who object to discriminatory taxes. In attempting to protect dry states against the inflow of liquor from wet states, the Repeal Amendment used broad language:[43]

> The transportation or importation into any State, Territory or Possession of the United States for delivery or use therein of intoxicating liquors in violation of the laws thereof, is hereby prohibited.

This language permits wet states as well as dry to set up their own laws as to the importation of liquor. Hence even outspoken plans for trade barriers are upheld. These are generally prohibitions presented in the form of tax discriminations.

Recently a miscellaneous group of legislative enactments has come into existence that presents if not a new at least a novel approach to the problem of controlling access to the market. The common fault that runs through most of these is the prohibition of new, unorthodox methods of reaching the public. From the lawyer's point of view these cases go back to *Rast v. Van Deman and Lewis*[44] and related cases, where it will be remembered the use of trading coupons, prize packages and that sort of thing came into collision with the legislative conception of public welfare, or possibly to the *Liggett* case,[45] in which the statute sought to oust chain drug stores. The modern cases differ from the older ones, however, in that the public aspect of the controversy is wholly lacking, or at least very thin. An excellent example is found in *Kress & Co. v. Johnson*.[46] The act in question forbade the conducting of a restaurant in any room where merchandising was carried on. The act was held constitutional. Rarely has judicial tolerance and indulgence in favorable presumptions of legislative reasoning gone further. In the same spirit an ordinance prohibiting the installation and operation of "automatic coin-in-the-slot" gasoline pumps has been upheld as a proper exercise of police power.[47]

Under the guise of police power there are each year proposed—and often enacted—bills to discourage new devices for all kinds of business. Paper containers are not to be used for milk;[48] grocery stores are not to sell camphorated oil;[49] door-to-

[43] U. S. CONST., Amend. XXI, §2. See State Board of Equalization v. Young's Market Co., 299 U. S. 59 (1936), and cases following it; Carr, *Liquor and the Constitution* (1940) 7 LAW & CONTEMP. PROB. 709; Note (1938) 38 COL. L. REV. 644.

[44] 240 U. S. 342 (1916).

[45] 278 U. S. 105 (1928).

[46] 16 F. Supp. 5 (D. Colo. 1936), *aff'd,* 299 U. S. 511 (1936).

[47] Hawkins v. City of Red Cloud, 123 Neb. 487, 243 N. W. 431 (1932).

[48] Ex-Cell-O Corp. v. City of Chicago, 115 F. (2d) 627 (C. C. A. 7th, 1940).

[49] Board of Pharmacy v. Abramoff, 6 N. J. Misc. 1109, 143 Atl. 764 (1928).

door selling is declared a nuisance;[50] markets must not supply baskets as a convenience to shoppers;[51] ice cream vendors must not offer their wares except in the hours when they are least likely to sell them;[52] a retailer may not manufacture;[53] a department store must have as many doors to the street as it has departments;[54] local agents must participate in the writing up of insurance risks;[55] prefabricated houses run into building code difficulties.[56] It is idle to forecast in which of the cases that have not yet been adjudicated the courts will choose to see the private economic motives to the exclusion of the constitutional pretense of public interests.

We have been discussing selected instances of publicly created market barriers. At some points they come perilously near to the private efforts in the same direction that have been condemned under the anti-trust acts. To what extent is a state law or a municipal ordinance to be regarded as a shield against prosecutions? Thus, if the grocers of a town were to conspire among themselves to keep a newcomer out, they might readily find themselves in the toils of the law. If instead, they conspire with a friendly city council to interpose tax, license, inspection and other hurdles—are they any the less guilty of a violation of the spirit or even the very letter of the anti-trust laws?

Anti-competitive state laws and ordinances, if they work at all, tend to destroy competition or eliminate competitors. In fact, the key to the whole trend that we have been examining is found in the new tolerance of courts as well as legislatures toward anti-competitive laws. The tendency has been obscured, of course, by a persistent refusal to call these laws by their proper names. The Federal Trade Commission unfortunately has no power to prevent legislatures from misbranding their laws. Congress itself set the example when it passed an act stopping competition at the vital point where the retailer stocks his shelves and called it an anti-trust law. The fair-trade acts have no more to do with fairness than did the codes of fair competition under the National Recovery Act. They attempt to cut off competition at the other vital point where the retailer passes on his goods to the consumer. The anti-loss-leader acts, by whatever name they are called, are likewise limitations on the freedom of competition. Now comes an avalanche of little laws calculated to keep from the market, under one pretense or another, the competition of certain persons, certain commodities, certain localities. The demand for these laws, the legislative response and the tolerance of the courts all reflect the same departure from the philosophy of the nineteenth century. We no longer believe in self-starting, automatically-controlled competition as nature's sacred device for regulating markets. We are quite willing to admit that some competition may be disagreeable and we venture at times to put forth a hand to steady it.

[50] Town of Green River v. Fuller Brush Co., 65 F. (2d) 112 (C. C. A. 10th, 1933).

[51] Great A. & P. Tea Co. v. Com'rs, *supra* note 41.

[52] Good Humor Corp. v. Long Beach, 22 N. Y. S. (2d) 382 (1940).

[53] Robertson v. Commonwealth, 168 Va. 752, 191 S. E. 773 (1937); the Patman anti-chain bill, discussed in Cook, *Legislative Restrictions on Marketing Integration*, *supra* this issue.

[54] ISAACS, BUSINESS LAW (Nat. Law Lib., 1939) 203. [55] Osborn v. Ozlin, 310 U. S. 53 (1940).

[56] State *ex rel.* v. Yoter, 65 Ohio App. 492, 30 N. E. (2d) 558 (1939).

COMPETITION AND MARKETING BARRIERS UNDER NATIONAL DEFENSE

Nathanael H. Engle*

Underlying Assumptions

Marketing Defined

Implicit in the title given to the present discussion are the assumptions that marketing barriers exist and that national defense is somehow concerned with, affected by, or affects existing marketing barriers. Marketing is a term not yet widely enough employed in scientific thinking to mean the same thing to all men. For the purposes of this discussion, the authority of the Committee on Definitions of the American Marketing Association is accepted. "Marketing includes those business activities involved in the flow of goods and services from production to consumption."[1] Our question may be stated thus, what barriers or obstacles lie in the path of those who would undertake the business activities involved in the flow of goods and services from production to consumption and how has national defense complicated or been complicated by the existence of such barriers?

National Defense

Before essaying an answer to this pressingly important question it is necessary in the interests of clarity and brevity to explain what is meant by national defense. National defense is first of all an economic job—the job of producing a two-ocean navy, a modern mechanized army, an invincible air force. In addition, national defense consists in producing all aid short of war for Britain and her allies. In brief, national defense means, in the words of our President, making America "the great arsenal of democracy."

National defense is no less a political job—the job of marshaling the forces of a great democracy behind the economic task in order to succeed in that task. It is a job of organization and administration, a job of cutting red tape, a job of streamlining, oiling, and operating at full speed the machinery of government itself.

National defense is equally a psychological and a social job—the job of building

* A.B., 1925, A.M., 1926, University of Washington; Ph.D., 1929, University of Michigan. Adviser on Distribution for the Consumer Division of the National Defense Advisory Commission. Formerly Assistant Director of the Bureau of Foreign and Domestic Commerce, in charge of research and statistics. Former president of the American Marketing Association and former editor of the Journal of Marketing, he has written widely on marketing problems. The views expressed in this article are his own, and in no wise to be interpreted as official expressions of the attitude of the National Defense Advisory Commission.

[1] (1935) 1 Nat. Marketing Rev. 156.

in the thoughts of the people a will to defend themselves. It is a task of galvanizing the millions of our people into unified action directed at the sole objective of safeguarding democracy.

Thus national defense is total defense—no less. It is the supreme effort and sacrifice of a nation aroused belatedly to the dangers which lie ahead in a world of unscrupulous gangster nations drunk with the blood of conquest and the lust for world dominion. As long as such a world exists, America must maintain invincible armaments. But invincible armaments are impossible without an invincible economy. Hence total defense must contemplate, indeed must build upon, a strong and effective economic structure. It is here that national defense overrides marketing barriers, for national defense can brook no obstacles to economic efficiency, and most marketing barriers must be considered as obstacles in the way of economic efficiency. The chief concern and hence the meaning of national defense for this article must therefore be economic efficiency.[2]

ECONOMIC BARRIERS TO MARKETING UNDER TOTAL DEFENSE

Two sets of obstructions to the free market may be observed—one set economic, the other legal. Economic obstacles inhere in the pattern of distribution channels which has emerged from the competitive struggle for market control, in the costs of distribution, and in the system of prices and price policies which prevail.[3]

How can one say that distribution channels, distribution costs, and prices and price policies are marketing barriers? They are not barriers in the fundamental economic sense, but rather comprise the mechanism whereby economic resources are allocated to socially desirable ends. In this sense, channels of distribution and particularly costs and prices determine, within limits, where and how the scarce factors of production, land, labor, capital, and enterprise, shall be utilized in satisfying the wants of society. In the long run only those enterprises can continue which meet the tests imposed by the cost-price relationship.

To the individual who would enter the field of marketing, however, the existing market structure and the conditions of resource use which prevail within it are very real barriers or obstacles to free action which must be faced or overcome as the price of success. The existing pattern of distribution, for example, while it provides opportunities within fairly wide limits for new and improved methods and devices, is nevertheless circumscribed at a number of points. Thus the growth of direct selling by producers quickly encounters obstacles, not the least of which is the greater efficiency of utilizing wholesalers' services for most commodities. Again, the expansion of chain store selling by the well-known cash-and-carry method has its limits in deeply rooted consumer buying habits, and cannot expand beyond that part of the market which is able and willing to pay cash and carry its own purchases home.

[2] For a recent discussion of the meaning of economic efficiency, see Engle, *Measurement of Economic and Marketing Efficiency* (1941) 5 J. MARKETING 335.

[3] See Craig and Gabler, *The Competitive Struggle for Market Control* (May 1940) 209 ANNALS 84; also Engle, *The Struggle for Market Control* (1941) T. N. E. C. MONOGRAPH No. 17, at 159.

The rôle of distribution costs as a barrier to marketing will be discussed more fully later. The fact that it requires labor, capital, and skilled management, all of which must be paid for, to conduct a marketing enterprise, is an easily understandable obstruction to successful and efficient distribution. The business junk yard is filled with the wrecks of those who failed to count the cost of distribution before embarking upon ill-fated marketing ventures. Similarly, prices and pricing policies are restrictive of free action in the market place. Too little known are the intricate processes by which prices are set on the multitude of commodities which flow through our markets. To the unskilled in pricing or to those unfamiliar with the pitfalls of price setting, the price system is a barrier to marketing activity. Indeed, it accomplishes its more vital function of resource allocation by very reason of the fact that it quickly becomes a barrier to the success of the incompetent.

Distribution Channels

With these thoughts in mind attention is first directed to the possible effects of a total defense program upon certain of the economic barriers to marketing. First of all, it seems reasonable to expect substantial changes in the existing distribution channels to result from defense. Starting with the manufacturers, defense spending is rapidly filling order books to capacity; directly through government orders, and indirectly through increased business from civilian buyers who find steadier work, more work, better pay. Responding to pressure for speedy production of government contracts and early deliveries, and finding that the long-standing buyers' market has become overnight a sellers' market, manufacturers, it seems reasonable to anticipate, will be less and less concerned with those expensive and elaborate schemes for direct selling which have engaged their attention in the recent past. More efficient sales outlets will be in demand. Agents, brokers, wholesalers, all specialists in performing the functions of the wholesale market, should look for additional business as a consequence of the reduced emphasis on direct selling.[4]

Some may say, at this point, what of the chains, what of the mass distributors, are they not more efficient than the wholesale agencies mentioned? The answer is at once yes and no; yes, in the sense that mass distributors have been able to cut costs on the goods they sell by the methods they employ; no, in the sense that, since they do not normally carry a full line of merchandise nor do they perform the normal range of marketing functions, their costs are not comparable to those of other distributors. On a strictly comparable basis as to functions performed, chains are not always more efficient than independents.

The stream of distribution may be likened to the delta of a great river. The main channel is wide and deep and can easily accommodate the largest boats. It may be more devious than some of the sloughs or branches which have cut their way directly to the sea but which are apt to be narrow and shallow. These can carry some of the lighter draft vessels directly and more quickly to their destination, but all the traffic cannot or may not care to utilize these routes.

[4] See Engle, *Adjustment of Wholesaling to 1941 and After* (1941) 5 J. MARKETING 431.

Independent wholesalers and retailers carry the main stream of goods which flow from producers to consumers. In 1935, independent retailers handled about two-thirds of all retail business covered by the Census; chain stores accounted for nearly 23 percent; department stores had nearly 10 percent; very small amounts were handled by mail-order selling and by house-to-house selling by manufacturers and others. Supermarkets were not shown separately but classified with either chains or independents.

Just as the delta of a river yields to the vagaries of the river's flow, cutting new channels here, returning to old ones, with nothing constant but change, so it is with the channels of distribution. Competitive forces, which stem from consumer buying habits, trade practices, and the urge for profits, condition fluctuations in these channels. Each channel has its own limiting factors. Independent retailers find their chief market in the patronage habits of the upper and lower income groups with some support from middle income families where, for various reasons, shopping for cash and carrying the goods home is not always convenient. The rich, by and large, patronize the better-grade independents by choice. The poor, by and large, support the small retailer by necessity. Giving part of their business to cash-and-carry outlets when they have the cash, the bulk of the purchases of those with very small incomes goes to the dealer who lends them credit from one pay day to the next and who tides them over periods of unemployment and adversity.

It is the middle class, by and large again, which have the cash, the time, and the inclination to buy from the cash-and-carry chains, the supermarkets, and other mass outlets. None of these groups is hard and fixed, but they nevertheless constitute limits to the expansion of the various types of distributors, even though the limits are flexible from time to time and from place to place.

Persistent evidence in the statistics that chains have about reached the limits of the demand for their brand of service leads one to conclude that no very great expansion lies ahead for them in the nation as a whole.[5] Competition, moreover, in the form of supermarkets and chain-trained and other up-and-coming independents,[6] some of whom band together to secure buying advantages or use the cash-and-carry technique of selling, still further circumscribes chain expansion on the supply side.[7] Defense prosperity may witness a continuation of this trend. In so far as the upper income group participates in recovery, larger patronage of the independents should follow. With fuller employment and steadier work there may be some falling away of the lower income groups to the mass distributors. Offsetting

[5] For an excellent analysis of the chain stores, see BECKMAN AND NOLEN, THE CHAIN STORE PROBLEM (1938).

[6] It should be noted, parenthetically, that direct buying is not new with mass distributors but is a practice engaged in by many independent retailers. See WHITE, COOPERATIVE RETAIL BUYING ASSOCIATIONS (1930) 164.

[7] The phenomenal expansion of supermarkets in the food field deserves much more than this footnote comment. The absence of official statistics makes it almost impossible to appraise its growth on a comparable basis with other retailing types. Moreover, supermarkets cut across the retailing picture with both independent and chain systems owning and operating them. See SUPER MARKET MERCHANDISING (Zimmerman, editor) for articles on the subject.

this trend is the probable shift of more of the middle income brackets to the independents. As unemployment wanes and disappears, more and more families may be found with both husband and wife working. Or wives may work while their husbands are in the armed forces. Such families have little time for shopping and may therefore utilize the services of independent retailers. Even though prices are slightly higher their larger incomes permit the enjoyment of the greater convenience of delivery and credit service. It is reasonable, however, to expect that the cash-and-carry chains will hold their own and possibly share in the general expansion of business.

Department stores are in a different class. Large-scale direct buyers, they sell on a service as well as a price basis. Enjoying roughly 10 percent of all retail business in the nation, there is evidence that they, like the chains, have reached the approximate limits of the market for their type of service.[8] A period of prosperity, however, may well provide enlarged volume, at least proportional to the general expansion. On the other hand, if competition from other mass distributors and from independent specialty shops develops from defense prosperity, department stores may encounter additional barriers. High operating costs have cursed the department store field for many years.[9] In the heat of a total defense effort, they may be able to reduce their margins by imposing rigid economies on all of their operations. If, instead, they yield to the temptation of easing up during the good times, they may find in their cost curves a still greater barrier to their expansion.

Cooperatives, another type of direct buying institution, are of two varieties, consumer owned, and distributor owned. The first can be quickly dismissed since it represents but an infinitesimal part of the retail market at this time. Little reason to anticipate much if any change in the consumer cooperative movement as a consequence of defense is apparent. If anything, the distractions of defense activities, the decentralization with consequent population shifts, the expanding incomes may be expected to muddy the waters of cooperative ventures and raise barriers to expansion. Distributive cooperation, on the other hand, should continue its progress. Combining as it does the advantages of large-scale purchasing with those of more personalized selling and service to consumers, the voluntary chain should be in a strong position to take advantage of the defense-generated prosperity.[10]

Distribution Costs

It is most important under total defense conditions that the barrier aspect of all marketing channels be minimized and the smooth flow of commodities facilitated. The emphasis will have to be on efficiency in marketing throughout all channels. Two areas need to be watched closely, distribution costs and commodity prices.

[8] There are of course variations between markets as between chains. Only the national averages are considered here.

[9] See Taylor, *Progressive Retail Management* (May 1940) 209 ANNALS 46, 49; operating cost studies of department stores, Harvard University Graduate School of Business; reports of the Controllers Congress, Nat. Retail Dry Goods Ass'n.

[10] For a basic study of distributive cooperation, see WHITE, *op. cit. supra* note 6, *passim;* see also BLANKERTZ, MARKETING COOPERATIVES (1940).

Spending, as we do, about one-third of the total national income on distribution costs, it is clear that such costs may easily represent a substantial barrier to consumption, as well as a hurdle which must be overcome by new entrants into the field of marketing.[11] It is imperative in times like these that distribution costs be kept to a minimum consistent with the efficient performance of the marketing functions. Cost accounting for distribution should be in order at each level of the marketing process. It is only through constant vigilance on the part of distributors based upon knowledge of individual items that excessive expansion of marketing costs can be avoided.

Prices and Pricing Policy[12]

It is at the pricing level that new entrants into the field of marketing usually awake to the fact that there are market forces at work which raise a powerful barrier to free action. Particularly important under national defense is the prevention of excessive price barriers to consumption of individual commodities both for civilian and military uses. Even more vital is the necessity for clipping the wings of inflation before the bird begins to fly. Demand factors, when taken alone, point to an upward trend. Billions of dollars for defense spell not only more direct demand for military goods and services; indirectly, through enlarged employment and purchasing power, they add up to greatly expanded demand for a wide range of consumer goods. In the end it seems inevitable that the demand forces must eventuate in strong business recovery and a sellers' market. Those who look no farther conclude that herein lies a parallel with World War I and that price increases, even inflation, are inevitable.

Fortunately for the American people, supply conditions render such an outlook most misleading. With huge surpluses of many basic agricultural products hanging over the market, and with export outlets almost completely cut off, it is difficult to envisage any very sharp increases in prices of most farm products, to say nothing of inflation. Again, in the manufacturing field, there remains, with some exceptions, much unused plant capacity, and a large army of unemployed labor. New capacity can be readily constructed where needed as long as labor and materials are available. Shortages may develop because of limited supplies of specially skilled labor, or because of inability to import commodities not available at home. Thus prices of an unknown but probably small number of items may rise. But as long as it is possible to marshal productive capacity to match increased demands no general widespread spiraling of prices should follow. On the contrary, in areas where plants have been inactive or operating at but a fraction of capacity, increased output may be had at a reduced unit cost, thus offsetting price increases in other less fortunately situated industries. The fact that production has been expanding rapidly

[11] See STEWART AND DEWHURST, DOES DISTRIBUTION COST TOO MUCH? (1939); Engle, *Costs and Profits in Marketing* (May 1940) 209 ANNALS 122; Engle, *Distribution Cost Analysis by Commodities* (Ninth Boston Conference on Distribution, Sept. 21, 1937).

[12] See Edwards, *Pricing Processes and Policies* (May 1940) 209 ANNALS 108; Mason, Nelson and Keim, *Price Behavior and Business Policy* (1940) T. N. E. C. MONOGRAPH No. 1; Gilbert, *Export Prices* (1940) T. N. E. C. MONOGRAPH No. 6.

under the defense program while the price level has moved upwards but very little attests to the validity of this analysis.

Legislative Barriers to Marketing Under Total Defense

Among the legal obstacles to free marketing activity are the many fungus growths of federal, state, and local laws which have mushroomed on the statute books of the nation, especially during the damp decade of the thirties. Worst of these clammy parasites, which make slippery footing for those who would tread the path of efficient marketing, are chain store tax laws, fair trade, and unfair practice acts. Each of these in its own way sets up obstacles to specified types of marketing, to marketing practices, or to the free determination of prices. Chiefly state and municipal legislation, some of these laws have been supplemented, aided, or abetted by federal statutes.

National Legislation

Since comprehensive national defense cannot be achieved short of general economic efficiency, legislative barriers to marketing must be appraised from the defense point of view in exactly the same terms as the economic barriers; they must, that is, be judged by their effect on efficient distribution. Every piece of legislation which touches upon marketing activities directly or indirectly is of concern to national defense to the degree that it blocks or facilitates efficient operations in the free market. A wide range of national legislation now encumbers the statute books—far too extensive to permit here of more than brief mention of a few of the recent and significant acts. Equally brief must be our statement of the underlying defense principle upon which appraisal and action may be based.

National laws which touch marketing practices range from the general anti-trust statutes through social legislation, specific agricultural marketing and foreign-trade laws, and the regulation of such marketing functions as transportation, under the Interstate Commerce Commission, and communications, under the Federal Communication Commission. By no means all of these laws are in the barrier class.

Anti-trust legislation, which heads the list in importance, aims at the elimination of obstacles to free competition, at the removal of trade restrictions, at monopoly and monopolistic practices. Total defense objectives are much the same in the long run. The great hue and cry raised in the press over seeming conflict between the enforcement proceedings of the Anti-trust Division of the Justice Department in the petroleum industry and the attitude of the National Defense Advisory Commission was not entirely justified. Long-run objectives coinciding, the question of timing of action which might delay the immediate procurement program is the only issue. Thus, it is possible that action, designed to break up vertical or horizontal combinations allegedly operating in restraint of trade, may prove unwise at a time when all-out efforts for defense are the major desideratum. Especially is this true when no question of efficiency is at issue but only the question of higher than

justifiable prices. Prices may be brought down, at least for the duration of the emergency, by less drastic measures, leaving until more peaceful days the task of trust-busting.[13] In the long run, "we, the people" are convinced that competition serves our ends better than monopoly in most economic activity. Where monopoly is inherent in the nature of an industry, it is accepted and regulated. Where monopoly cannot be justified or regulated, the anti-trust laws are designed to eliminate it.

The Robinson-Patman Act, which was designed to equalize the buying advantages of large- and small-scale operators, is a natural outgrowth of the Sherman Act, the Clayton Act, and the Federal Trade Commission Act. While it does set up obstacles to utter freedom of marketing activity, its avowed purpose is to restrict only unfair or monopolistic practices, presumably inimical to the best interests of consumers and marketers alike. National defense efforts introduce no change in this basic philosophy.

Not so with other types of legislation of a more restrictive nature. Laws which inject inflexibilities into the pricing structure obstruct effective marketing and run counter to the national defense effort. Among these are tariff barriers which shut out or limit the flow of essential commodities. The conflict with defense from such measures is well illustrated by the requirement that military purchases of woolen goods be confined to domestic wool. On representation of the Consumer Division of the National Defense Advisory Commission, this limitation was lifted with the result that unnecessary price increases were averted or minimized.[14] Tariff and other restrictions which create artificial shortages of badly needed commodities that are abundant in world markets are clearly barriers which should not be tolerated by a nation aiming at speedy total defense.

One other federal statute, among the many which affect marketing in varying degrees, deserves mention here. The Miller-Tydings Act essentially extends the rights of resale price maintenance under state fair trade laws to interstate commerce. Passed as a rider to an appropriations bill, this law encourages price setting with its concomitant rigidities throughout the market structure. Taken in conjunction with some of the state laws next to be discussed, the Miller-Tydings Act is definitely earmarked as one of the barriers to the free market, which runs counter to the interests of a nation arming itself for defense.[15]

While other federal statutes bearing on market distribution, such as were briefly mentioned above, exist, they do not, for the most part, constitute barriers from the standpoint of national defense in the same sense or to the same degree as do those

[13] See the discussion of divorcement of production and distribution in Cook, *Legislative Restrictions on Marketing Integration;* Edwards, *Economic Implications of Business Boundary Laws,* both *supra* this issue.

[14] Address by Miss Harriet Elliott at the annual meeting of the National Consumers League, New York, N. Y. Consumer Division, Nat. Def. Adv. Comm., release, Jan. 11, 1941, at 6.

[15] See testimony of Dr. Corwin Edwards of the U. S. Dept. of Justice before the T. N. E. C., Feb. 10, 1941.

singled out for discussion.[16] For any specific law the general principle applies that wherever the statute does prove to be a serious handicap to efficient and economical marketing, it may be taken for granted that such legislation runs counter to public interest under a total defense régime.

State Legislation

More serious in the sense that they are more numerous and, with possible exceptions, free of federal control, are the legal marketing barriers of the various states. Over forty states have whelped wolfish resale price maintenance laws which parade under the sheep's clothing of fair trade.[17] Fair to whom, is the question which consumers raise. Since the objective of these laws is to prohibit the free determination of prices by wholesalers and retailers, their end result is to destroy one of the major bases of competition in a free market. The facts adduced by studies of the actual effects on prices under these laws, that prices have not been increased, in fact may have been reduced somewhat on the average, are beside the point. Actually, *minimum prices* have been raised; consequently those consumers who buy at the minimum are penalized. The main point, however, is that such legislation militates against free competitive price determination at every level of the market, and consequently has the effect of freezing an existing market structure. Obviously here is a barrier or an obstacle to new and improved methods which might cut distribution costs and reduce prices to consumers. Indeed such new methods would have difficulty in establishing themselves as long as they are deprived of the right to present their case to consumers in the understandable language of lower prices.[18]

Closely akin to resale price maintenance legislation are the so-called unfair trade practices acts which have been passed by some thirty states. These laws purport to prevent unfair competition by prohibiting sale of commodities below cost. Taken at face value little or no objection can be made to this principle, certainly not from the national defense angle. Only when cost is interpreted by some artificial and unrealistic formula do these laws become marketing barriers. Where these laws permit each merchant to set prices on the basis of his own costs, competition continues to function. But when costs are defined arbitrarily and raised to excessive levels, without benefit of a scientific cost survey, as appears to have been true in Colorado recently, the legislation becomes restrictive and tends to raise prices.[19]

In addition to fair trade and unfair practice acts, a large number of states have introduced and some have passed tax laws designed to curb the growth of chain store distribution. Quite apart from the legal merits of singling out a particular type of retailing for special persecution, the incidence of chain store taxes tends to

[16] See, *e.g.*, legislation covered in *Note on Governmental Product Favoritism, supra* this issue.

[17] See OPPENHEIM, RECENT PRICE CONTROL LAWS (1939).

[18] For an analysis of fair trade legislation, see GRETHER, PRICE CONTROL UNDER FAIR TRADE LEGISLATION (1939); Grether, *Marketing Legislation* (May 1940) 209 ANNALS 165. For a trade survey, see OSTLUND AND VICKLAND, FAIR TRADE AND THE RETAIL DRUG STORE (Druggists Research Bureau, 1940).

[19] According to newspaper accounts this situation has been investigated by the U. S. Dept. of Justice.

be upon the prices charged by the chains.[20] To the extent that chain prices have been lower than those charged by independents, consumers have profited. By the same token, consumers tend to bear the brunt of chain store tax legislation where such laws either compel the chains to raise their prices or to close their doors. At best it amounts to the state raising revenue by tapping the savings of those consumers who patronize the chains. Since chains have established a reputation for efficiency in the performance of those distribution tasks which they undertake, and since special chain taxation tends to offset chain store advantages and raise costs, chain store taxation is definitely in the barrier class.

A fourth group of state laws, those classified as interstate trade barriers, are also of significance to national defense. Adequately covered elsewhere in this symposium, suffice it to point out that many of the acts falling in this category are apt to conflict definitely with national defense efforts. Thus restrictions on certain types of transportation may impede the speedy and efficient movement of materials across state lines. Again, should shortages develop in particular commodities, such as butter, state barriers to the importation and sale of substitutes would run counter to defense.[21] Such laws should be vigorously combated whenever and wherever they interfere seriously with defense efforts. Even where the federal government has no jurisdiction over state legislative barriers to the free market, it seems inevitable that local public opinion will rally to the support of the government and see to it that obstacles in the way of effective total defense are removed. Any other policy would spell the inconsistency of persisting in courses of action directly contrary to the dominant interest of the nation.

Finally, there is a potential threat to defense efforts in a type of state legislation which has not yet made perceptible headway with legislators. Efforts have been made to secure the passage of laws, clearly in the barrier class, designed to prohibit business men from simultaneously engaging in manufacturing or processing and marketing or distribution activities.[22] Reminiscent of ancient guild restrictions, these laws aim at the erection of barriers around traditional types of business activity and the prevention of anyone not specializing in a particular occupation from encroaching into other fields. Thus retail drug stores or soda fountains would be prohibited from manufacturing ice cream, retail grocers would not be allowed to handle drug store items, and public utility companies would be prevented from selling appliances. Running counter as they do to the strong current in merchandising practice of handling wider and more generalized lines of commodities by a growing variety of stores, it would seem that there is little likelihood of their success. Organized minority trade groups continue to push for such legislation, in

[20] See Due, *The Incidence of Chain Store Taxation* (1940) 5 J. MARKETING 128.

[21] For discussion and criticism of existing barriers to margarine, see Truitt, *Interstate Trade Barriers in the United States; Note on Governmental Product Favoritism*, both *supra* this issue.

[22] Federal, state and local enactments and proposals of this type are collected by Cook, *Legislative Restrictions on Marketing Integration;* McIntire and Rhyne, *Municipal Legislative Barriers to a Free Market*, both *supra* this issue. They are analyzed from the general economic point of view by Edwards, *Economic Implications of Business Boundary Laws*, *supra* this issue.

the ever-springing hope of the business man that he can somehow get *his* business out of the competitive class. But the chances of success would seem to be slight. Growing self-consciousness of consumers coupled with the self-interest of competitive business groups should be able to stem the tide.

Contributing to hope for a more liberal policy is the fact that many, if not most, of the various types of barrier laws were the fruit of the depression era, now definitely on the wane. They represented the blind groping for an easy solution to problems which were deeply rooted in fundamental economic maladjustments. Moreover, the results of these palliative measures have generally fallen far below the expectations of their sponsors.[23] The net of these factors is that the elimination or minimization of both federal and state legislative barriers to marketing, in so far as they are also barriers to national defense, should not prove impossible.

CONCLUSIONS

What conclusions can be drawn from this brief examination of economic and legislative barriers to marketing, as they impinge upon national defense efforts? National defense cannot reshape overnight the trend of thought and action which through the years has built marketing barriers. Hence, it is necessary to differentiate the more immediate outlook from that of the longer run.

In the immediate future the conclusion seems warranted that some success may be achieved in reducing economic barriers to efficient marketing. For example, a shift towards more efficient distribution channels is already in evidence. Efforts towards reducing distribution costs are afoot. Limitations on speculative excesses and avoidance of price spiraling are recognized as essential to defense. With the transition from business recovery to widespread prosperity, it may be anticipated that additional gains will be made in minimizing the economic barriers to marketing. The very pressure of a total defense effort will contribute to this end. At the same time constant vigilance must be exerted to avert the tendency for new barriers to appear under the guise of defense-generated necessity.

On the legislative front, the outlook is less clear. It would appear reasonably certain that defense requirements for efficient distribution should override any national legislative barriers. Initial progress has been made, as noted above, in the relaxation of the domestic wool purchase requirements. Other obstacles to total defense will undoubtedly crumble under the impact of the requirements for building a strong bulwark for our democracy. State legislation will probably be slower to yield, so that immediate relief from the multitude of state marketing barriers may not be realized. Ultimately, however, as defense becomes more and more a stark reality throughout the nation, state barriers, too, should give way to the necessity for building that strong and efficient economy without which no national defense effort can succeed.

[23] Recent accounts of cancellation of fair trade contracts by manufacturers illustrate this. See, *e.g.*, action of Denton Sleeping Garment Mills in issuing a folder to customers entitled, *Farewell Fair Trade*, J. Commerce and Commercial, Feb. 11, 1941, at 11.

INTERNAL MARKETING BARRIERS IN EUROPE: PRE-HITLER AUSTRIA AS AN OUTSTANDING EXAMPLE

Jacques Kunstenaar*

I

Pre-Hitler Austria is the classic example of a country subjected for years to an economic ideology that became the forerunner of those forces which made her ripe for annexation. In order to understand this development, we have to go back to the year 1848. The Revolution of 1848 did not substantially affect the economic constitution of Austria, its guild system, which since the Middle Ages had had a strong position in the old Austro-Hungarian Monarchy. On the contrary, growing industrialism, the development of Vienna and Bohemia as centers of European trade and surprising technological progress brought a decline of artisanship which resulted in a tremendous economic and political reaction on the part of the so-called Austrian middle class. That group was never able to grasp the true significance of liberalism, and the formation of large-scale enterprises, such as modern factories, department stores, *etc.*, was considered as an attack of "Judaism and Free Masonry" against the small bourgeoisie. The competitive struggle between declining artisanship, partisan to the past, and the founders of the new economic order became a first-class political issue.

The ideological forefathers of today's National Socialism—Ritter Georg von Schoenerer, the Christian-Social anti-Semitic mayor of Vienna, Karl Lueger, and the Julius Streicher of the nineteenth century, the Christian-Social councilman and master-mechanic, Schneider—knew how to utilize that economic development for their own political ends. This was especially the case with Dr. Lueger, who succeeded in winning over the major part of the small bourgeoisie to the Christian-Social party, which little by little became the center of Austrian reactionaries. The so-called *Gewerbeordnung,* a body of laws and decrees concerning the plying of a

* A.B., 1923, Ph.D., 1932, University of Zurich (Switzerland); London School of Economics; University of Florence; Graduate Institute for International Studies, Geneva. Consulting economist to the Department Stores Association of Switzerland, Associated Cement Industries of Switzerland, *etc.* Member editorial staff of *Agence Télégraphique Suisse;* economic and financial correspondent Amsterdam daily *Algemeen Handelsblad.* Associate member of Haworth, Powell & Thomas, New York City. Author, The Budget of the League of Nations (Zurich, 1932).

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handicraft or trade, became more stringent from year to year. The artisans hoped that through the elimination of competition they would obtain a kind of monopoly which would help them to fight successfully the rising industrialists. Every artisan was compelled by law to be a member of his professional corporation or guild. The leaders of these guilds, the *Vorsteher,* virtually had the power of life and death over members. Their fight against the lower prices of industrial goods was made possible through cutting the costs of hand labor. This they could do because the guilds were entitled to fix the conditions to be complied with in order to become an artisan. For example, any young man who wanted to become a barber had to be an apprentice for four years and a journeyman for many years before he qualified for the master's examination. As a rule, the apprentice did not receive any salary. He had to work 12 to 16 hours a day and his master had the right to beat him. As a matter of fact, he was not treated much better than a slave. After one or two years of apprenticeship, he already did the work of a fully qualified craftsman and therefore the master had, free of charge, a real artisan in his employ. In many cases the number of apprentices was not even limited and thus the masters often had three or four workers whose labor cost them no wages.

The social legislation of the years 1918-1920 did away with the major part of these guild prerogatives. The guilds, or corporations, remained, however, and the *Gewerbeordnung,* though modified, was taken over as to its basic ideas. It cannot be denied that a certain liberal wind started to blow. This was especially true in Vienna under the social-democratic régime which lasted until February, 1934. But, when Chancellor Dollfuss took over power in 1933 and instituted the partially Fascistic régime in Austria, the old guild spirit re-awoke. From then on, new internal marketing barriers sprang up continually to throttle Austria's economic life.

In the years 1934-1938 no enterprise, were it commercial, industrial, or handicraft, could be opened in Austria without the consent of the proper professional corporation. In nine out of ten cases the men who had to make the decisions were direct competitors of the petitioner. If, for example, a seamstress wanted to move her shop to the house across the street, she had to have the consent of the Tailors' Guild and of the competent government office. Not until the competitors had granted her request was she allowed to move. As a rule, and for obvious reasons, requests of this kind were refused.

The same state of affairs existed in regard to factories. According to information from reliable sources, the use of bribery often removed obstacles. Ordinary law making was eliminated and the government ruled by decrees. These decrees of the years 1933-1938 were based on the emergency measures of 1917. The case of the industrial enterprise *Manfred Weiss* in Vienna is especially illustrative. This firm established a sewer-pipe factory in Vienna with a capital investment of 5,000,000 schillings. Several hundred workers had found occupation in that factory, a fact of significance inasmuch as at that time there were not less than 800,000 unemployed in Austria. At the occasion of the festive opening of the factory, a representative of

the Minister of Commerce, Stockinger, welcomed the new undertaking and thanked the management on behalf of the Austrian Government for the newly created employment possibilities. Only one day later, however, the Minister of Commerce decreed that a special license was necessary to operate the pipe factory. This decree had retroactive force. The management of *Manfred Weiss* applied for a license and was refused. What had happened? Simply that a competitor of *Manfred Weiss* had used his influence with the Minister!

But not only industry and handicraft suffered internal marketing restrictions; commerce also had to overcome enormous difficulties. At the request of small shopkeepers, the few existing variety stores were ordered to close. If a retailer wanted to open a new shop or add new departments or expand his store, he had to have the consent of the professional organization and of the appropriate government office. Exporters and importers too had to be members of compulsory corporations. The destiny of large enterprises was often in the hands of some petty official. It is said that corruption was the order of the day from 1934 to 1938 and that few ministers were incorruptible.

Price-fixing laws were an integral part of the internal marketing barriers in pre-Hitler Austria. There was practically no economic domain without legal restrictions on the free play of prices. So-called minimum prices were fixed, providing that all goods and services which were affected by these laws could not be sold or rendered below the price fixed by law. As a consequence of these barriers, which practically excluded price competition, consumption diminished and the economic situation of this already impoverished country, with hundreds of thousands of unemployed, became worse and worse. The minimum prices affected mainly those in whose interest they were supposedly established; the small traders and the artisans were the first to suffer from the decline in consumption.

But, the vicious circle was started and there was no way out. The peak was reached when "economic experts" proposed to help the small traders and artisans against their more potent competitors by the introduction of a special tax on machines. In other words, every manufacturer who wanted to add a new machine to his factory would have been obliged to pay a tax. In this way it was hoped to combat efficiency and progress in the interests of a certain class of the population and, willingly or unwillingly, against the interest of the consuming population as a whole. The Council of Ministers studied this taxation plan very thoroughly and examined it in five special sessions. One member of the cabinet actually offered his resignation in case this plan should fail of adoption. It was only the meritorious combined effort of the Austrian Manufacturers Association *(Verband der österreichischen Industriellen)* and the Exporters Incorporated in the Viennese Merchants Guild *(Wiener Kaufmannschaft)* which prevented this idiotic plan from being put through.

It is worth while noticing that these same "protectors" of the small traders and artisans did concede monopolies to certain big firms when it suited their political

aims. Thus the whole steel industry, at both the production and merchandising stages, was in the hands of or at least dependent upon, the German *Alpine Montan Gesellschaft*. This enterprise advanced large sums to finance the Austrian Fascist guard, the *Heimwehr*. It had a great influence on the governments of Dollfuss and Schussnigg. The company was so strong that it secured protective tariffs even for qualities of steel which it did not itself produce. Interviewed at a press conference about the catastrophic consequences of this protective tariff policy, a director of the *Alpine Montan Gesellschaft* cynically invited rival artisans and manufacturers either to adapt themselves to the qualities which the company was willing to produce, or to quit business.

Internal marketing barriers were also to be found in Austrian agriculture. An illustrative example: farmers received 18 groschen for a liter of milk, whereas the consumer had to pay 49 to 52 groschen for it. A kilogram of butter cost the consumer 4 schillings to 5 schillings 50, whereas the farmer received only 1 schilling 60 for it. Austrian butter, however, was exported to England at the price of 1 schilling 10 a kilogram. The difference between 1 schilling 10 and 1 schilling 60 was paid to the farmer out of public funds. For every liter of milk, 3 groschen had to be paid by the consumer into a so-called Milk Compensation Fund *(Milchausgleichskasse)*.

The butter price was so high in Austria that butter became prohibitive for the majority of consumers. The public turned more and more to the cheaper margarine. The government retorted by taxing the manufacturers of margarine to such an extent that margarine nearly reached the price of butter. The consumption of margarine therefore dropped too although the consumption of butter did not increase, because people simply could not afford to buy it. As a consequence of this economic policy the production of margarine had to be restricted and the number of unemployed was again augmented.

We find the same disastrous effects caused by internal marketing barriers and especially by price-fixing in other agricultural fields, particularly in the sugar and wine industries. The fixing of minimum prices caused consumption to decrease; the farmers, in whose interest price-fixing was decreed, were drawn deeper and deeper into the crisis.

Thus under the half-Fascistic régimes of Dollfuss and Schussnigg internal barriers became a source of personal aggrandizement to a few political leaders, while unemployment rose from day to day. Farmers, manufacturers and merchants became more and more involved in debt. Import duties were raised but tax revenues dropped. The consumption of practically all foodstuffs and articles of daily use decreased sharply. A sense of bitterness took hold of large parts of the population. Workers and employees, former Social-Democrats, were already opposed to the Austrian form of Fascism. The so-called middle class and some of the farmers who first had sympathized with the Dollfus and Schussnigg régimes for their reactionary economic philosophy in opposition to economic progress and efficiency, began to set their hopes on German National Socialism.

There can be no doubt as to the reciprocal action of internal marketing barriers and the political happenings in Austria. Indeed, there is probably no country in Europe in which economic legislation and, especially, internal marketing barriers had such an influence on national political development as in Austria. It is not impossible that without the events of February, 1934, and without the exhumation of the old Austrian guild constitution at that time, Austria might today still be an independent country.

II

Illustrative of the absurd lengths to which the Austrian internal marketing barriers were carried was the federal law establishing arbitration courts for price-cutting cases, decreed by the government on October 26, 1934 *(Bundesgesetz über die Errichtung von Schiedsstellen für Preisschleudereisachen)*. This Austrian law was a very careful attempt to solve the problem of price-cutting. For its execution arbitration courts were formed consisting of one professional judge as president and two members of the trade or profession involved in the case as associate judges. The jurisdiction of these courts covered, so far as price-cutting was concerned, offenses against the Austrian law of unfair competitive practices which by paragraph 1 declares:

> Whosoever in business engages in unfair competitive practices can be restrained from continuing the offensive procedure and can be held liable in damages therefor.[1]

The law became effective on the first of November, 1934, with a provisory validity until the 31st of December, 1935. The short period of validity was to enable the law-makers to obtain some experience which would place them in a position to work out a law modified by experience or to prolong the life of the original enactment. But the effects of the law proved so disastrous that it had to be repealed when it expired at the end of 1935.

Though the Austrian press was censored and could not give free vent to the true feelings of the economic circles involved, it is nevertheless possible to cite some newspaper articles which are characteristic of the objections created by this law. The semi-official *Reichspost,* commenting in No. 259 of the 19th of September, 1935, on a lecture delivered by Dr. Wilhelm Loebell, a high government official, wrote:

> The decisions of the arbitration courts are contradictory. The same facts are declared legal in one case and illegal in another and this leads to considerable insecurity. This is not meant as a criticism of the arbitration courts, which were created without being afforded guidance as to what price-cutting really means. The artisans, who form an important part of our corporative order, have, in the last few years, forcefully demanded that offenders committing price-cutting be legally liable. The law-makers did their best to meet that wish and studies were made by competent organizations to define price-

[1] "Wer im geschäftlichen Verkehr zu Zwecken des Wettbewerbes Handlungen vornimmt, die gegen die guten Sitten verstossen, kann auf Unterlassung und Schadenersatz in Anspruch genommen werden." In the pages following free translation is given to German language sources.

cutting. It must, however, be said that the organizations approached were not in a position to define the meaning of price-cutting.

Even members of the Austrian Chamber of Artisans *(Oesterreichische Gewerbebund)* developed a critical attitude toward the legal possibilities of combating price-cutting. Dr. Ernst Stadler, executive secretary of the Association of Austrian Artisans, declared in No. 276 of the *Reichspost* of the 6th of October, 1935:

The decisions of the arbitration courts have been disappointing in many cases, as they were to a high degree contradictory and unstable. This is not due to the fault of the arbitration courts, but to the fact that there is no definition of what price-cutting really means.

The former Austrian Chancellor, Ernst Streeruwitz, one of the most ardent proponents of a law against price-cutting and who was, to a great extent, responsible for its enactment, had, during the year 1935, much cause for comment on the experiences with this temporary law. In No. 278 of the *Reichspost* of the 8th of October, 1935, Streeruwitz said:

It cannot be denied that a certain uniformity in the decisions of the arbitration courts must be demanded. It must be recognized, however, that in view of the tremendous number of cases and the short time during which the law was enforced, it was not easy to regulate satisfactorily the intervention in the mechanism of prices.

A law system which does not guarantee uniformity in the application of justice must be denounced as a sheer legalization of arbitrary methods.

The application of the law produced, as a further consequence, a sizable increase in consumer prices. On the 14th of March, 1935, the prominent Austrian newspaper *Neue Freie Presse* published the following letter to the editor:

A few days ago my wife wanted to buy a pat of margarine, for which she used to pay 68 groschen. The grocer told her, however, that though he regretted it, he had now to get 88 groschen for the same amount of fat. He had been perfectly satisfied with a profit of 20%, but he had been denounced as an offender against the price-cutting laws and was now obliged to take a profit of 42%!

In the *Reichspost* dated July 6th, 1935, we read as follows:

A grocer was denounced by members of his guild because he had sold salad oil below the decreed retail prices. To that he objected that he was making a profit of 13% as he was able to buy at favorable prices and conditions. He urged, moreover, that his overhead charges were very low, as he conducted the business with the sole help of his wife. His average income amounted to about 500 schillings a month. He stated furthermore that salad oil of a similar quality was being sold in the market at the same price. In the decision of the arbitration court, these points were not questioned. It was, however, concluded that the merchant had sold under the retail prices decreed by his guild. His sales had therefore to be considered as an unfair competitive practice. The majority of his colleagues had been adhering to the fixed prices. The earnings in individual cases were considered by the law courts as absolutely irrelevant.

An editorial of the *Reichspost* of the 6th of July, 1936, is equally illustrative.

Within the last few months we were compelled several times to criticize certain factors contributing to the fixation of price in Austria. Even if the tendency toward rising prices is based on the decisions of the arbitration courts, this status is unbearable. Just now, even if we ignore our external competitive needs as to export, tourism, etc., the fact remains that what is necessary is higher market turnovers and not higher prices. We could not hope for such an increase if prices had a tendency to rise, while the income remained the same. We must not allow such a price formation which results in a diminution of the volume of trade, even if this tendency is based on juridically correct decisions of the arbitration courts. It is not feasible to force the arbitration courts to fix prices for goods or services.

On the 3rd of January, 1936, that is, three days after the law in question became inoperative, the semi-official *Reichspost* commented editorially as follows:

The Reichspost has many times had cause to show by drastic examples the weaknesses of the law, which in a number of cases proved to be nonsensical. Not infrequently did it harm the serious merchant satisfied with a fair profit, but who, by reason of his efficiency, could sell cheaper than his competitor who cited him before the court of arbitration.

On the 6th of March, 1936, Minister Baar-Baarfels delivered a lecture before the *Niederösterreichischer Gewerbeverein* in which he definitely shattered the hope of those who still believed in a revival of the court of arbitration in price-cutting cases. The experiences gained had convinced even partisans of this economic philosophy that it was, in the end, a shortsighted policy. Baar-Baarfels said:

I want to state forcefully that the Government is not inclined to interfere with the mechanism of prices by fixing them authoritatively or by passing similar measures. It is the Government's aim to create a condition which would warrant a fair income to production and to the small and large trade. Excess profits would only result in a superfluous increase in prices which would be felt by the consumer. We are by no means advocating a competition free of any and all barriers, but we are not willing by forceful intervention to eliminate the economic laws concerning the price mechanism.

The decisions of the courts of arbitration show conclusively that it is impossible to define the meaning of price-cutting in an objective manner and that such an attempt to settle complicated economic processes by law was bound to fail. In point because it illustrates to what absurd lengths these kinds of laws can be abused is decision Ps 6/35-5 of the 9th of March, 1935. There an innkeeper was sued by his competitors because he had sold half a broiler with potato salad at the price of only 1 schilling. In a lengthy dissertation, the court analyzed the case and decided finally that no offense against the law was committed.

In decision Ps 8/35-4 of the 14th of March, 1935, the defendant was found guilty, because he had sold a tube of dental cream at 1 schilling 20 instead of the fixed price of 1 schilling 40. In the opinion of the court it is stated that a buyer sent by a competitive firm went into the store and positively begged the merchant to sell her the dental cream at the lower price. The merchant finally, though reluctantly,

agreed; whereupon he was denounced by his competitors. In decision Ps 62/35-8 of the 24th of May, 1935, a house painter was found guilty of unfair competitive practices because he had undertaken a painting job at a lower price than was usual among his competitors for this kind of work. He was restrained from continuing the offensive procedure and held liable in damages therefor in spite of the fact that his profits amounted to 439 schillings 76 on a bill of only 1,313 schillings 73! In decision Ps 39/35-7 of the 25th of April, 1935, a grocer was found guilty of price-cutting because he had been able to pass on to the consumer the advantages of his efficient buying and organization. In spite of the fair income of 600 schillings monthly which he was able to make while charging lower prices, he was condemned because he had sold at a cheaper price than did the majority of his trade. This was considered by the arbitration court to be an unfair competitive practice.

The foregoing are just a few illustrative examples, which could be multiplied indefinitely, of the pernicious effect on Austrian business and consumers of one of the most back-breaking and economically unjustifiable of internal marketing barriers.

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